S. HRG. 99-519

THE LEGACY OF THE JAPANESE VOLUNTARY EXPORT RESTRAINTS

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE, PRODUCTIVITY, AND ECONOMIC GROWTH

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

FIRST SESSION

JUNE 24, 1985

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

56-201 O WASHINGTON : 1986

J841-11

JOINT ECONOMIC COMMITTEE

[Created pursuant to sec. 5(a) of Public Law 304, 79th Congress]

HOUSE OF REPRESENTATIVES

DAVID R. OBEY, Wisconsin, *Chairman*
LEE H. HAMILTON, Indiana
PARREN J. MITCHELL, Maryland
AUGUSTUS F. HAWKINS, California
JAMES H. SCHEUER, New York
FORTNEY H. (PETE) STARK, California
CHALMERS P. WYLIE, Ohio
DANIEL E. LUNGREN, California
OLYMPIA J. SNOWE, Maine
BOBBI FIEDLER, California

SENATE

JAMES ABDNOR, South Dakota, *Vice Chairman*
WILLIAM V. ROTH, JR., Delaware
STEVEN D. SYMMS, Idaho
MACK MATTINGLY, Georgia
ALFONSE M. D'AMATO, New York
PETE WILSON, California
LLOYD BENTSEN, Texas
WILLIAM PROXMIRE, Wisconsin
EDWARD M. KENNEDY, Massachusetts
PAUL S. SARBANES, Maryland

SCOTT LILLY, *Executive Director*
ROBERT J. TOSTERUD, *Deputy Director*

SUBCOMMITTEE ON TRADE, PRODUCTIVITY, AND ECONOMIC GROWTH

SENATE

WILLIAM V. ROTH, JR., Delaware, *Chairman*
PETE WILSON, California
WILLIAM PROXMIRE, Wisconsin

HOUSE OF REPRESENTATIVES

DANIEL E. LUNGREN, California, *Vice Chairman*
PARREN J. MITCHELL, Maryland
JAMES H. SCHEUER, New York

CONTENTS

WITNESSES AND STATEMENTS

MONDAY, JUNE 24, 1985

	Page
Lungren, Hon. Daniel E., vice chairman of the Subcommittee on Trade, Productivity, and Economic Growth: Opening statement	1
Chafee, Hon. John H., a U.S. Senator from the State of Rhode Island	2
Smith, Hon. Michael B., Acting U.S. Trade Representative	15
Crandall, Robert W., senior fellow, the Brookings Institution	48
Keller, Maryann N., director and auto analyst, Vilas-Fischer Associates, Ltd., New York, NY	61
Hufbauer, Gary Clyde, senior fellow, Institute for International Economics	73
Angel, Robert C., president, Angel Associates, Inc	103

SUBMISSIONS FOR THE RECORD

MONDAY, JUNE 24, 1985

Angel, Robert C.: Prepared statement	107
Chafee, Hon. John H.: Prepared statement	6
Crandall, Robert W.: Prepared statement	53
Hufbauer, Gary Clyde:	
Prepared statement	76
Preliminary case study on automobiles, dated June 1, 1985, by the Institute for International Economics	83
Keller, Maryann N.: Prepared statement	65
Smith, Hon. Michael B.: Prepared statement, together with a data appendix	20
UAW International Union: Statement of	123

THE LEGACY OF THE JAPANESE VOLUNTARY EXPORT RESTRAINTS

MONDAY, JUNE 24, 1985

CONGRESS OF THE UNITED STATES, SUBCOMMITTEE ON TRADE, PRODUCTIVITY, AND ECONOMIC GROWTH OF THE JOINT ECONOMIC COMMITTEE,

Washington, DC.

The subcommittee met, pursuant to notice, at 2:07 p.m., in room 2168, Rayburn House Office Building, Hon. Daniel E. Lungren (vice chairman of the subcommittee) presiding.

Present: Representative Lungren.

Also present: Kenneth Brown and John Starrels, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE LUNGREN, VICE CHAIRMAN

Representative LUNGREN. Welcome to this hearing of the Subcommittee on Trade, Productivity, and Economic Growth of the Joint Economic Committee, entitled "The Legacy of the Japanese Voluntary Export Restraints."

In 1981, the United States entered into a voluntary export restraint [VER] arrangement with Japan for the purpose of temporarily reducing that nation's automotive exports to the United States.

From the outset, we were assured that the VER's primary purpose was to facilitate the long overdue modernization of our ailing automotive industry. In exchange for short-term protection, the industry would agree to undertake the necessary efforts to ensure its future competitiveness.

Now that the administration has announced its intention to let the VER lapse, I believe it is an appropriate time to ask, and I hope to answer, two fundamental questions to be addressed by our fine witnesses this afternoon.

First, is the U.S. auto industry indeed better off, and more competitive, as a result of the 4-year VER with Japan?

Second, what place, if any, should VER have in the future conduct of U.S. trade policy?

We must not lose sight of the broader issues surrounding today's hearing. Because over the past decade, U.S. international competitiveness has apparently declined, as reflected in our trade deficit and the major sectoral problems gripping the country.

How to arrest this decline? Through revaluation of the dollar or the imposition of import barriers? Proposals such as these are ad-

vanced daily around the country and in the Halls of Congress. But in my view, protection and other forms of intervention are not the answer. We need instead a market-oriented approach which addresses those longer term structural problems which are the root cause of our competitive decline.

These are the concerns that bring us together today. So I am very pleased that we have before us such distinguished witnesses who will shed appropriate light on our long-term competitive challenges.

We will have my esteemed colleague, Senator John Chafee, appear first, followed by Ambassador Michael Smith, Acting U.S. Trade Representative.

They, in turn, will then be followed by two panels for our other participants. I hope and pray that not everybody will agree and we will get a good exchange of ideas here.

So first, I would like to welcome Senator John Chafee from the State of Rhode Island, and, Senator, welcome, and you may proceed as you wish.

STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator CHAFEE. Well, thank you very much, Mr. Vice Chairman.

First, let me commend you and members of this subcommittee for convening this hearing to assess the legacy and the impact of the Japanese voluntary automobile export restraints on the American economy.

The suggestion, one of the points you made in your opening statement, was whether this is the proper route to go, and I think we can gain something from looking at what was the result of the restraints that were imposed on the Japanese imports.

These voluntary restraint arrangements—now, I have called them the VRA's—have been both a rescue mission for Detroit and a dragging anchor on the economy. For 4 years now American consumers have paid a heavy "tax" on the cars they buy in the form of premium prices caused by these import restrictions.

Anyone who has visited an auto showroom knows what has happened to prices, not only for foreign cars but for domestic cars as well, protected as they have been from foreign competition. How many consumers on moderate incomes can afford the $13,000 average price of a General Motors car?

Meanwhile, the automobile industry, both here and in Japan, piles up record profits. In 1984, American carmakers reaped $10 billion in profits, rebounding from the loss of $4.2 billion in 1980. The auto industry in America is looking forward to another banner year in 1985. So this isn't an industry that needs indefinite protection. Because of limitations in the number of cars they could sell, Japanese automakers naturally shifted exports to the larger, more expensive models, turning these restraints into a rather profitable arrangement for themselves. For Detroit, the reduced competition in the low cost end of the market helped keep prices up. However, the low-income consumer looking for an economical small car, was left out in the cold.

Now, the quotas, as you recall, were adopted "voluntarily" by the Japanese under pressure from the United States. This was in the spring of 1981 when the U.S. industry was—so it appeared to be—on its knees, caught with large, fuel-guzzling cars after oil prices skyrocketed. American auto producers said they needed some breathing space; this is a familiar lament that you have mentioned in your opening statement. The manufacturers needed a little time to gear up for a new era in automobiles. The quotas were only intended to last a maxium of 3 years, the time period Detroit said it needed. Instead, they lasted 4 years and the Japanese are still, as you know, exercising some restraint. Certainly 4 years was plenty of time.

These quotas didn't come cheap. Profits per vehicle are twice the level they were 10 years ago. In 1984, it is estimated that Americans paid an extra $5 billion because of the import limits—that is $5 billion in 1 year alone. In a report released February 9 of this year, reviewing recent developments in the U.S. automobile industry, the International Trade Commission [ITC] estimated that over the past 4 years, voluntary restraints cost American consumers an additional $15.7 billion over what they normally would have paid. Despite these costs, relatively few new jobs—about 26,000—were created in the automobile industry as a direct result of these quotas. That means that the quotas cost consumers over $160,000 per job annually. Another study by the FTC which put the figure at a yet more amazing $240,000, nearly a quarter of million dollars, per job.

The good times are here again for Detroit. Last year, the U.S. auto industry had its best sales year since 1979, earning, as I said, $10 billion. There is no doubt that auto quotas contributed to the profitability of the domestic auto industry, but there is little evidence that these quotas were used by auto industry management to advance the industry's competitiveness.

Robert Crandall, of the Brookings Institution has documented that investments between 1975-76 and 1979-80; by domestic auto makers, increased 88 percent. However, since the auto quotas were put in place real investment by the industry has actually fallen by 30 percent.

High profits from quotas relax pressure for wage restraint. It started with the executive bonuses. Flushed with their 1983 profits, the domestic auto companies distributed record bonuses to their top executives. The top 5,800 GM executives received bonuses of $181 million for the year, averaging about $30,000 apiece. Ford Motor Co. Chairman Philip Caldwell received a $900,000 cash bonus on top of a $520,000 a year salary. He also exercised stock options worth an additional $5.89 million in net pretax value. The top Ford executives received 1983 bonuses totaling $80.6 million.

If the industry was strong and healthy enough to pay such compensation to its executives, then why did it need protection? Consumers and the Congress should certainly feel that we have been had. By continuing these quotas, we handed the consumer to the auto management on a silver platter.

Now, what about the workers? The American autoworker is the economic royalist of the American work force. He averages $22 an hour in wages and fringe benefits, compared to a national manu-

facturing wage plus fringes average of less than $13 an hour. Are these workers prepared to help themselves in the industry's competition with the Japanese? Have they been willing to reduce their wage package in order to reduce the cost of the product they assemble so more U.S.-made autos could be sold and more of their laid-off fellow autoworkers could go back to work?

The answer is clearly "no." The American autoworkers show no inclination to take any cuts, not in their wages nor their age 55 retirement with 30 years service nor on their first dollar coverage for all medical care. Last year, the U.S. auto industry signed a labor agreement that will raise total wages and fringe benefits for the average autoworker to about $50,000 a year. This is for workers who have already earned 60 percent more than the average manufacturing worker in the United States. The International Trade Commission found that during the period of import restraints, the average hourly wage of American autoworkers increased by nearly 50 percent, rising from 15.33, excluding benefits, during the first 6 months of 1984. That wage was two-thirds higher than the average for all manufacturing workers in 1984.

Now, here is the question: Why should a Rhode Island worker who makes less than half of what autoworkers are paid be forced to pay $2,000 more for his car because the competition is kept at bay to protect the jobs of a few? I find it very difficult, indeed, to justify these kinds of disparities in our economy. Even during the auto industry's recent prosperity we still hear the argument that quotas ought to be extended once again to allow U.S. autoworkers to become competitive with the Japanese. This is an old protectionist refrain refuted by the facts. History shows that trade protection removes the incentives for companies to make the difficult decisions needed to become cost competitive. It is doubtful that the recent wage settlements and executive bonuses that U.S. auto companies provided would have been quite so generous had quotas not protected U.S. automakers from Japanese competition. As the sad state of our steel industry shows, an industry that enjoys protected markets too long will fail to take the measures needed to stay competitive.

I congratulate President Reagan on his decision not to seek the extension of these quotas. I would hope the Japanese Government would not continue to impose restraints voluntarily on auto exports as a favor to the United States. Implicit in such a dubious favor is the mistaken understanding that the United States will not demand that Japan open its fastest growing markets—telecommunications and other high technology equipment; software; and agricultural and pharmaceutical products—to American firms. In other words, the Japanese feel pressure is taken off them from opening their markets because they have agreed to the extensions of U.S. restraints.

Now, Congressman Lungren, I don't think we should seek to balance our trade by limiting the sale of competitive Japanese products in our market, or should a literal balance of trade be our goal. Rather, we should demand that our trading relations with Japan be based on the simple concept of comparative advantage. The whole point of trade is to shop around the world for the best available product at the best available prices, and we expect that policy

from Japan. American firms that have a natural market in Japan should be able to pursue it just as Japanese automakers should be able to pursue the healthy American automarket without impediment. Otherwise, the basic political requirement for trade, a sense of mutual advantage, disappears.

As long as we keep our market open without restrictions on their billion dollar sales of automobiles, we have the right to demand access for our goods which are price competitive and to recognized superior quality. Both American and Japanese consumers deserve the protection that comes from free competition in the marketplace.

If the American automobile industry is to be competitive, then competition must be allowed. The chairman of General Motors, Mr. Roger Smith himself, noted not too long ago in a Washington Post column: "The discipline of worldwide competition * * * speeds up the pace of technological innovation and industrial modernization, which means growth and more better jobs."

Consumers, workers, and the auto industry itself deserve to have these restraints put to rest. At the same time we have a right to demand access to Japanese markets for our products that are competitive there. Thank you for your time, Congressman Lungren.

[The prepared statement of Senator Chafee follows:]

PREPARED STATEMENT OF HON. JOHN H. CHAFEE

Thank you Mr. Chairman. Let me first commend you and this Committee for convening this hearing to assess the legacy and impact of Japan's voluntary automobile export restraints on the American economy.

The vitality of the auto industry is important because its employment, its gross sales, its impact on our way of life are so pervasive. Consumers care deeply about the cost, quality, safety, and environmental soundness of their cars, and they care very much.

These voluntary restraint arrangements--let's call them VRA's--have been both a rescue mission for Detroit and a dragging anchor on the economy. For four years now, American consumers have paid a heavy "tax" on the cars they buy--in the form of premium prices caused by these import restrictions.

Anyone who has visited an auto showroom knows what has happened to prices, not only for foreign cars but for domestic cars as well, protected as they are from foreign competition. How many consumers on moderate incomes can afford the $13,000 average price of a General Motors car?

Meanwhile, the auto industry--here and in Japan--piles up record profits. In 1984 American car makers reaped $10 billion, rebounding from a loss of $4.2 billion in 1980, and is looking to another banner year in 1985. This is not an industry that needs indefinite protection. The Japanese automakers, limited in the number of cars they could sell, naturally shifted exports to the larger, more expensive models, turning these restraints into a rather profitable arrangement. For Detroit, the reduced competition in the low-cost end of the market helped keep prices up. And the unfortunate, low-income consumer looking for an economical smaller car was left out in the cold.

The quotas were adopted "voluntarily" by the Japanese, under pressure from the U.S., in the spring of 1981 when the U.S. industry was on its knees. Caught with large, fuel-guzzling cars when oil prices skyrocketed, the American auto producers said they needed "breathing space" to gear up for a new era in automobiles. But the quotas were intended to last only three years--the amount of time Detroit said it needed. They lasted four, and the Japanese

are still exercising some degree of restraint on their auto exports. Surely four years was enough breathing space.

These quotas did not come cheap. Profits per vehicle are twice the level they were ten years ago. Last year alone, it is estimated that Americans paid an extra $5 billion because of the import limits. The International Trade Commission, in a report released February 9 reviewing recent developments in the U.S. automobile industry, estimated that voluntary restraints cost American consumers $15.7 billion over the last four years. Despite these costs, relatively few new jobs--about 26,600-- were created in the auto industry as a direct result of these quotas. That means these quotas cost consumers over $ 160,000 per job annually. Another study by the Federal Trade Commission puts the figure at a yet more amazing $240,000 per job.

Good times are rolling again for Detroit. Last year, the U.S. auto industry had its best sales year since 1979--earning a record $10 billion profit. There's no doubt that auto quotas contributed to the profitability of the domestic auto industry. But there is little evidence that these quotas were used by auto industry management to advance the industry's competitiveness.

Robert Crandall of Brookings has documented that investments between 1975-76 and 79-80 by domestic automakers increased eighty

eight percent. Since auto quotas were put in place however, real investment by the industry has actually fallen--by thirty percent.

High profits from quotas relaxed pressure for wage restraint. It started with executive bonuses. Flush with their 1983 profits, the domestic auto companies distributed record bonuses to their top executives. The top 5,807 GM executives received bonuses of $181.7 million for the year, averaging about $30,000 each. Ford Motor Company paid Chairman Philip Caldwell a $900,000 cash bonus on top of a $520,000 salary; Mr. Caldwell also exercised stock options worth an additional $5.89million in net pretax value. The top Ford executives received 1983 bonuses totaling $80.6 million.

If the industry was strong and healthy enough to pay such compensation to its executives, then why did it need protection? Consumers and the Congress should certainly feel that we have been had. By continuing these quotas we handed the consumer to auto management on a silver platter.

What about the workers? The American auto worker is the economic royalist of the American workforce. He averages $22.00 per hour in wages and fringe benefits, compared to a national manufacturing wage plus fringes of less than $13.00 an hour. Are these workers prepared to help themselves in competing with the Japanese? Have they been willing to reduce their wage package in

order to reduce the cost of the product they produce so more U.S. made autos can be produced and more of their laid-off fellow auto workers could go back to work?

Not on your life. The American auto worker has shown no inclination to take any cuts--not in their wages, nor their age 55 retirement with thirty years service, nor in their first dollar coverage for all medical care. Last fall the U.S. auto industry signed a labor agreement that will raise total wages and fringe benefits for the average auto worker to about $50,000 a year. This is for workers who are already earning sixty percent more than the average manufacturing worker in the United States.

During the period of the import restraints, the average hourly wage of American auto workers increased by nearly fifty percent, rising to $15.33 (excluding benefits) during the first six months of 1984. That wage was about two-thirds higher than the average for all manufacturing workers in 1984.

Why should a Rhode Island worker, who makes less than half of what auto workers are paid, be forced to pay $2,000 more for his car because the competition is kept at bay to protect the jobs of a few? I find it very difficult indeed to justify those kinds of disparities in our economy.

Despite the recent prosperity in the industry, we still heard the argument earlier this year that quotas ought to be extended once again to allow U.S. automakers to become "competitive" with the Japanese. This is an old protectionist refrain refuted by the facts. History shows that trade protection removes the incentives for companies to make the difficult decisions needed to become cost competitive. It is doubtful that the recent wage settlements and executive bonuses at U.S. auto companies would have been quite as generous had the quotas not protected U.S. automakers from Japanese competition. As the sad state of our steel industry shows, an industry that enjoys protected markets too long will fail to take the measures needed to stay competitive.

I congratulate the President on his decision not to seek the extension of these quotas. I had hoped the Japanese government would not continue to impose restraints voluntarily on auto exports as a favor to the United States. Implicit in such a dubious "favor" is the mistaken understanding that the U.S. will not demand that Japan open its fastest growing markets: telecommunications and other high-tech equipment, software, agricultural and pharmaceutical products. That is no bargain.

We should not seek to balance our trade by limiting the sale of competitive Japanese products in our market. Nor should trade balanced in terms of actual dollars be our goal. Rather we

should demand that our trading relations with Japan be based on the simple concept of comparitive advantage. The whole point of trade is to shop around the world for the best available products at the best available prices. And we expect the policy from Japan. American firms that have a natural market in Japan should be able to pursue it, just as Japanese automakers should be able to pursue the healthy American auto market without impediment. Otherwise the basic political requirement for trade, a sense of mutual advantage, vanishes.

But so long as we keep our market open, without restrictions, for their billion dollar sales of automobiles, we can and will demand access for our goods which are price competitive and of recognized superior quality. Both American and Japanese consumers deserve the protection that comes from free competition in the marketplace.

If the American auto industry is to be competitive, then competition must be allowed. GM Chairman Roger Smith himself noted not too long ago in a Washington Post column: "the discipline of worldwide competition...speeds up the pace of technological innovation and industrial modernization, which means growth and more and better jobs." Consumers, workers, and the auto industry itself deserve to have these restraints put to rest, and for good.

Representative LUNGREN. Thank you very much, Senator. I know that in the Senate you have been one of those who have spoken out against these restraints in the past, arguing that the Japanese must also open their markets to us. I would like to address this last issue with you.

Some say that the most effective way to leverage, or influence, the Japanese to open up their markets is to use a scalpel—as opposed to a butcher knife: To tell them, in effect, that if they don't open up their markets, for instance, in the area of the electronics industry there we will punish them on the automobile side because that is a place where they have made a real entry into the United States. How do you respond to that sort of an argument?

Senator CHAFEE. I think these voluntary restraints give away the game to start with because they have proven very profitable for the Japanese, as you know. The Japanese have gone into the higher end of the market, where they can make more dollars. By even suggesting to them that we like the restraints, we reduce the chances of getting our products that are truly competitive into the Japanese market. We are not going to sell more automobiles in Japan. I don't think anybody in their wildest imagination says there is a market for U.S. automobiles in Japan. But with the retraints, they say, "Here, we have restrained, so we don't have to give way in other places, and we have restrained on shipping automobiles to you so we are going to keep out your pharmaceuticals or electronic products."

In other words, they have seized the high ground to a degree, giving them a rationale for keeping out our products; whereas, if we let in their automobiles and concentrate on the electronic products, we can even exercise reciprocity. They sell a lot of electronics in the United States. We think there is a market for telecommunications products in Japan. I think we ought to say to them. "You let our telecommunications products in or we won't let yours into this country," and that will get their attention just as much as automobiles will.

Representative LUNGREN. In other words, United States efforts to negotiate a freer trade relationship with Japan should be principally directed toward the goal of obtaining reciprocity in the same industry or the same lines within an industry?

Senator CHAFEE. I think so. I would suppose you could lead me along and show me some area where we have a better product that they are not selling here but we are selling there, soybeans for example. But, I think that telecommunications is an area where they are selling a lot here and they are not letting our products in to the extent they should.

So to the extent we can, yes, I would limit it to the particular product rather than some different product, such as keeping out automobiles in order to get in telecommunications.

Representative LUNGREN. It is terribly difficult to ask any member of a legislative body to forecast what that body might do. But I just wonder if you might share with us your thoughts on current Senate sentiment on dealing with the trade deficit with Japan, and how that deficit relates to automobile voluntary restraints.

Senator CHAFEE. Well, as far as voluntary restraints on automobiles, I don't think we are going to do anything because I think our Government can rightfully say we haven't put any pressure on the Japanese for the automobile restraint. They have done this by themselves. And so, in answer to your question, I don't see anything happening there.

Clearly, there is a protectionist sentiment building up in the Senate in other areas. What is going to happen? I don't know. The administration's position is very clear, as you know, and the administration has proven to be very influential, not just in the Senate but in the whole Congress. I think you can safely say that the Senate is very reluctant to get into this protectionist business. They know from history full well what happened in the 1920's; the 1930's. Smoot-Hawley is a name that has a most familiar ring in the Senate.

However, there is a sense of frustration about the Japanese denial of access to their markets in areas where we are clearly superior, and the easiest product to discuss is telecommunications. There I think you might well see some bills demanding reciprocity pass. How it will work, what the administration will do, I don't know, but in the area of telecommunications there is a strong sentiment to do something.

Representative LUNGREN. Well, thank you, Senator, for being our leadoff witness.

My purpose in holding these hearings is to have us examine what it is we've done in the recent past. So oftentimes I find that we either pass legislation or an executive branch does something unilaterally and after a time is past and they've done it, we move on to something else or we reimpose it without much thought as to what the consequences were of our particular actions. And I just think that we need to take a look at what the results were of this period of time in which we have had these voluntary restraints.

I might tell you that we had endeavored to have representatives of the auto manufacturers—the "Big Three"—to appear and also the UAW. The UAW will be submitting testimony but could not appear. The "Big Three" could not appear either. I'm sorry because I would rather have an opportunity to have them here and have a discussion going forward with those suggesting they worked or they didn't work and why. So we could get it out on the table at one time.

But I thank you for your testimony.

Senator CHAFEE. Well, thank you, Congressman Lungren, for your interest, energy, and dedication in holding these hearings. I think you're right on the mark to do it. Thank you.

Representative LUNGREN. Thank your very much, Senator.

Next, we have on the panel, Ambassador Michael Smith, the Acting U.S. Trade Representative. I believe he has recently returned from Japan. I hope he's had enough time to catch up on the jet lag. Ambassador Smith, your full statement will be made a part of the record. You may nevertheless present it as a whole, or in part. Welcome.

STATEMENT OF HON. MICHAEL B. SMITH, ACTING U.S. TRADE REPRESENTATIVE

Mr. SMITH. Thank you, Congressman Lungren.

You're correct in saying I just returned from Tokyo, so if I sound a little disjointed today, it's not my normal confusion—or at least it's caused a bit more by sitting on an airplane for 14 hours.

Senator Chafee, sir, has given some of the economic background, so let me first say that I appreciate this opportunity to appear before you and your subcommittee and I thought maybe it'd be useful, rather than getting into all the background on the voluntary export restraints, to touch a bit on that second part of the question that you addressed, that is, what has been the effect of such restraints and what are implications for those in terms of trade policy.

My own personal expertise is in the trade policy area rather than industrial economics, so I'm sure you'll understand if I concentrate more on the trade policy side of the question.

By the way, sir, having just returned from Japan, if you have any questions regarding that, I'd be glad to answer those at the conclusion of my presentation.

The first question that perhaps we could ask rhetorically, is what has been the immediate effect of those Japanese automobile export restraints. Well, first, you could say that they did achieve their intended purpose, that is to say they provided a breathing space for U.S. manufacturers to introduce new, more fuel-efficient products, improve quality and productivity, and restore profitability.

Second, you could say that the industry did invest about $80 billion in property, plant, and equipment, and about $17 billion in product research and development between 1978 and 1985, recognizing that the restraints, of course, did not come into effect until 1981.

Additionally, you could point out that the U.S. auto producers reduced their break-even points by slashing fixed costs so that the previous break-even level of 11.2 million units was reduced to about 8 million units, currently.

Third, you could say—according to the Department of Commerce estimates—that the restraint resulted in an additional U.S. production of between 700,000 to 1,250,000 automobiles, resulting in an additional between 54,000 and 105,000 jobs and added somewhere between $1.2 to $2.2 billion to the combined net incomes of the "Big Three" during the 1983-84 period.

On the negative side of the ledger, you could argue that the price effects were, according to most analysts, substantial. As Senator Chafee referred, the ITC has estimated that domestic prices—that is to say domestically produced automobile prices—increased by perhaps as much as $660 per unit and imported Japanese cars by as much as $1,340 per unit directly as a consequence of the 4 years of restraint. And as has earlier been pointed out, some estimates are that the cost to the U.S. consumer over the 4 years was something just under $16 billion.

One point which is not often thought of, but I'm sure an economist or a trade-policy person, indeed, an automobile industrialist would want to think about, that there is a negative, another nega-

tive, in terms of the economic rents. In terms of the restraints the, if you will, the rents accrued to the Japanese companies. The restraints, of course, were intended to assist the U.S. companies. But what they also did is they increased the profits of their Japanese competitors which, in turn—and here is the irony—were plowed back into more innovation and productivity increasing investments that enhanced the long-term competitiveness of the Japanese industry.

In fact when I was in Japan a couple weeks ago, I was told that one of the Japanese automobile companies out of the $1.2 billion net profit it made, $800 million came from the sales in the United States and the second-largest out of its net profits of $550 million, $350 million came from United States sales of which, respectively for each of those two producers, 50 percent of those profits were plowed back into R&D. So in a way, if you will, the restraints are paying for future Japanese competitiveness.

In terms of the long-term effects of the restraints, Congressman, some recent analysis would indicate that even when the restraints are terminated, they will have only transitory effects on the long-term competitive situation in the U.S. market. Actions the industry and labor themselves can take to improve their competitive situation will continue to determine the future of the industry.

During the 1985–89 period, the U.S. automobile manufacturers are expected to invest over $50 billion on new products, plant, and equipment with the objective of becoming fully competitive with foreign-based manufacturers in world markets. Whether this, indeed, turns out to be the case is, of course, something we will have to see.

Turning, if I may now for a moment, sir, to the question of VER's or VRA's as a trade policy tool. I notice that Senator Chafee called them VRA's. Some would say that a VER, which is a voluntary export restraint, the word "voluntary" is perhaps sometimes misleading. So one can call them either VRA's or VER's.

But the question that comes up is—and you had asked in your letter of invitation—as to what do we think about them as a general use as a trade policy tool.

In my prepared statement I had cited that in 1980 the USITC voted negatively three to two on the Auto Industry Import Relief case. The Commission's negative determination with respect to injury, legally prevented the President from having the opportunity to use section 201 of the Trade Act of 1974 to restrict imports through tariffs or quotas or tariff rate quotas or orderly marketing agreements, another acronym, OMA.

The section 201 process is the U.S. domestic analog to article XIX or the "escape clause" contained in the GATT. Article XIX of the GATT provides for the temporary suspension of certain GATT obligations if increased imports are the cause of or threaten to cause serious injury to a competing domestic industry.

This article also provides for full notification and consultation with other interested parties and nondiscriminatory application on a most-favored-nation basis of any import restricting actions.

In turn, if you do that, exporting countries then have the right of retaliation. But in practice, a frequent result is that appropriate

compensation in the form of lower tariffs in other product areas is negotiated.

Now, why do I dwell on this? Despite the existence of article XIX and its occasional use, in recent years article XIX has been largely observed in the breach—the current situation is marked by a proliferation of arrangements of which the Japanese auto restraint is only one example—that are not covered by existing GATT rules and are referred to as "gray area" restraints.

The history of the negotiation of article XIX suggests that it was designed to discourage excessive use of the escape clause, or safeguard action as it is called, by setting a high standard and by exacting through compensation or retaliation a cost to the country taking such action.

Over time, however, particularly with chronic high unemployment rates among developed countries and sluggishness in the world economies, the cost of meeting the requirements of article XIX have been too great. Some have not wanted to or were unable to pay the compensation bill on the increasing volume of trade under "gray area" restraints or desire to prolong the imposition and nature of the restraint well beyond the temporary and digressive standards set in article XIX.

Another reason for the use of these gray area measures was their selectivity, such as in VRA's or VER's. Because some felt that trade frictions might be reduced if you negotiated these trade restrictions between just two or several parties rather than on an MFN basis.

Unfortunately, Congressman, the informal nature and lack of transparency of some of these gray area actions, have made protectionist actions easier to take when they are not or were not really justified.

A side effect is that you—in these gray area measures—get trade diversion leading other countries to adopt their own import restrictions.

Differences in structure and circumstances from one industry to another will continue to require a case-by-case analysis over which trade, economic, or antitrust policy tools, would be most effective in dealing with a specific fair or unfair trade situation that is causing or threatening injury to a domestic industry.

Notwithstanding our own use of VRA's or VER's, they and other gray area measures, such as industry-to-industry agreements and forecast by the exporting country, in our view, must be brought into the GATT system.

The United States remains committed to the goal of reaching multilateral agreement on a new comprehensive multilateral safeguard system within the GATT framework. This is an issue of interest to the developed and developing countries alike and efforts are being made to advance the safeguards negotiations in the context of the preparation for the new GATT round.

If I may here, sir, add something.

The key to all of these measures which are taken, not just by the United States or by Japan or by the European community, is that in a classic safeguards action, what we call our section 201, which is we pointed out is the analog to article XIX of the GATT, one is supposed to pay compensation.

When you have a situation like you do between Japan and the United States, or Europe and Japan, or Europe and the United States, when the tariff rates are already down to an average of 4.2 percent ad valorem as they will become January 1, 1987, there is very little left to compensate with particularly if the trade item on which you are taking safeguards action is so huge, in this case, automobiles.

Let's say that, for example, the volume of trade between Japan and the United States in automobiles is $15 billion. You couldn't compensate if you took restraint action on automobiles.

The alternative is for Japan to raise its traiffs to, if you will, counter retaliate. That starts getting yourself into a difficult situation contrary to the idea of freeing trade, of liberalizing trade.

So countries have resorted to these gray area measures to such a degree that it's estimated by some—these may be the pessimists of life—but some say that the current GATT rules cover only 5 percent of world trade. I think that's an exaggeration, but the fact is that the GATT secretariat itself in 1982 announced to the world that of the $63 billion worth of safeguard actions, only $2 billion were taken through the normal GATT process of article XIX. In other words, $61 billion were done outside the provisions of the agreement to which we all signed up as contracting parties. This indicates, if you will, some of the problems, the dilemmas, that from a trade policy point of view, VER's or VRA's present.

In sum, what the administration has been trying to do for the last 3 years, is to get an internationally reinforced agreement on safeguards which would do at least five things and hopefully more.

They are, first, transparency, that is that the safeguard action you take is open and known to everybody.

Two, that the action is digressive; that is, if you take a restraint in which, let's say, you restrain—you have a quota which restrains 100 percent or stands still the first year, it should be less strict the second year. Let's say, the quota should have increased to 120 percent or to 140 percent or whatever it is, so that the second year is less strict than the first year, and the third year is less strict than the second year. That is foreseen in GATT theology, and indeed, is in the trade laws of the United States.

The third element that we've been trying to get world agreement on is that restraints should be time-certain. They should begin on a certain day and, most importantly, they should end on a certain day. Most thinking on the subject recently has been somewhere between 2 to 5 years, depending on the case.

Fourth, that restraint actions—and there is some controversy about this—be in the form of tariffs and not in the form of quotas. There is some argument about this among economists and trade aficionados, but it is generally felt that if you're going to take a restraint action, you're best off if you put it right up front as to what it's costing, so that people know. The problem about quotas is that you don't really know, the cost is disguised and it is some time before it becomes evident.

Obviously a fifth element, which is to be desired but in many, many cases difficult to carry out, is the question of adjustment and how one facilitates adjustment.

But those, sir, would be my opening comments on the question of the implications and the use of restraints as a matter of trade policy.

[The prepared statement of Mr. Smith, together with a data appendix, follows:]

PREPARED STATEMENT OF HON. MICHAEL B. SMITH

Mr. Chairman:

I appreciate the opportunity this Subcommittee has afforded to examine both the immediate and some of the longer-term effects of the Japanese Government's auto export restraints to the United States, as well as to explore the broader implications of employing such mechanisms as voluntary export restraints and other voluntary restraint arrangements (VRAs) as a trade policy tool. Since my personal expertise is in trade policy rather than industrial economics, I will largely focus my remarks on the trade policy issues raised by the auto restraints and by VRAs, more generally, as they affect the United States and our trading partners.

For purposes of clarity of the record, let me begin by reiterating the Administration's present position on the Government of Japan's auto export restraints. On March 1, after a review of the United States-Japan trading relationship, including the issue of auto restraints, the President decided not to urge the Japanese to extend their unilateral auto export restraints to the United States. Notwithstanding this position on the part of the Administration, the Japanese Government announced its own decision to continue to limit automobile exports to this country for another year, April 1985 through March 1986, at a level of 2.3 million units. This level is 24 percent higher than the 1.85 million unit level of the previous year, April 1984 through March 1985.

The Administration subsequently responded to the Japanese Government's decision by stating that the extension of the automobile export restraints was not a substitute for that Government meeting its commitments to open its own market fully to U.S. products and services. The Congress, as we know, also responded with concurrent resolutions addressed toward rectifying our trading imbalance with Japan (H.Con.Res.107 and S.Con.Res.15).

Japanese Market Access

As you are aware, Mr. Chairman, I have just returned this weekend from a series of meetings with my Japanese counterparts focused on precisely this issue of full market access. These meetings are the results of an initiative agreed upon in January between Prime Minister Nakasone and the President to intensively work toward removing all trade barriers to the Japanese market, both formal and informal, in four key sectors: telecommunications, forest products, medical equipment/pharmaceuticals, and electronics. However, our interest in full access to the Japanese market is certainly not limited to just these four sectors; rather they were chosen in order to concentrate our special efforts on selected manufactured products in which we felt that U.S. producers were particularly competitive, based, in part, upon the commercial experience of head-to-head competition against the comparable Japanese products in third markets. While Japan is our largest overseas agricultural market, the resistance of the Japanese market, not only to U.S. manufactured exports, but manufactured exports from the rest of the world, has been a major irritant in our trading relations.

The discussion in these four sectors is receiving high level political involvement. The interagency teams have been chaired by undersecretaries or their equivalents, on the U.S. side from the Departments of Treasury, Agriculture and Commerce, and USTR. This work has been closely followed on both sides of the Pacific by other Cabinet officers, as well as by the President and the Prime Minister.

Following up on the earlier initiative, Prime Minister Nakasone, in April, demonstrated commendable leadership by expressing the objective of changing certain policies and long-held attitudes, that have kept Japanese markets effectively closed to U.S. goods, by making an unprecedented appeal to the Japanese people to embark on the path toward free trade. The Prime Minister's announcement not only included recommendations for diverse market opening measures covering the four manufacturing sectors already under discussion, but also in the area of financial and legal services and in some specific areas, like high cube containers for maritime shipping. Although the April announcement included few new or immediate market opening measures, the Japanese Government is developing and will release in July what they have called an "action plan". This plan is intended to describe the specific steps to be taken to reduce barriers to market access in the areas of tariffs, standards, government procurement and other, formal and informal, import restrictions.

The Origins of Auto Export Restraints

Let me now turn more directly to the issue before us today, the effects of the Japanese auto export restraints. To put the issue

in perspective, let me take just a few moments to recount the origins of those restraints.

When the Government of Japan, four years ago, first decided to restrain their manufacturers' auto exports to this country, it took that action in recognition of the difficult adjustment situation that the U.S. automotive industry was facing with respect to inadequate production capacity in fuel-efficient cars.

The domestic industry adjustment problems were further compounded by a combination of external and internal factors: Sharply rising fuel prices and sporadic fuel shortages, following the oil supply disruption of 1979, had resulted in a sharp shift in demand from large cars to more fuel-efficient vehicles. U.S. manufacturers were unprepared to respond to such a rapid swing in demand. Domestic production costs and auto prices were also rapidly increasing; and quality and value, as perceived by the American consumer, were not keeping pace. Interest rates were at record highs and the entire economy was slipping into the sharpest recession since World War II. Simultaneously, international competition in automotive products was intensifying, placing extraordinary adjustment pressures on the domestic auto industry, its suppliers and their workers.

With the U.S. manufacturers taking a smaller share of a shrinking pie, the result was the worst car sales year for the U.S. industry in two decades. All the other industry statistics turned sharply negative. Compared to 1978, which many analysts had considered to be the last good year before the full weight of the adjustment causing factors was felt, by 1980, the U.S. motor vehicle industry profits before taxes dropped from a positive $8.9 billion to a loss of $3.8 billion. Import market share shot up from 17.7 percent to 26.7 percent, and employment in the industry dropped from over 1 million workers in 1978 to under 800 thousand workers in 1980. The corresponding unemployment rate for this industry grew from 4.1 percent to 20.4 percent over this same period. The latter number was almost triple the national average unemployment rate for all civilian workers. One company was on the verge of bankruptcy. Serious questions were being raised as to where the companies were going to get the financial capital necessary to make the massive investments necessary to meet the fuel economy requirements mandated both by the marketplace and by statute.

Separately, the U.S. International Trade Commission (USITC) had ruled negatively, in a 3-2 vote, on an industry petition for import relief under Section 201 of the Trade Act of 1974. The USITC found, in the autumn of 1980, that imports were not the substantial cause of serious injury to the domestic automotive industry.

Against this backdrop, permanent auto import restrictions were seriously proposed in the Congress in the Spring of 1981. And even after the Japanese Government's export restraints were put

into place on May 1, 1981, automobile domestic content legislation, which is nothing more than disguised quotas, passed the House on two separate occasions. (You will recall that the Administration opposed these permanent restrictions in the strongest terms.)

This suggests to me that the proper yardstick for measuring the effects of the Japanese restraints might not be simply against what might have happened in an entirely unfettered market situation, as estimated in most of the econometric models on this issue, but rather against much more severe market restrictions which would likely have been the realistic alternative.

Current Condition of the Industry

The current condition of the U.S. auto industry has obviously vastly improved from what it was four years ago. The industry is now in its third year of expansion. Sales, employment, and the financial strength of the U.S. manufacturers are at their highest levels in several years. U.S. manufacturers produced 10.9 million motor vehicles in 1984, an 18 percent increase above the 1983 figure. Retail sales of American-built motor vehicles reached 11.5 million units (7.95 million cars and 3.5 million trucks), a 22 percent improvement over the year-earlier amount. These were the highest levels since 1979. Despite generally softer retail sales in 1985, sales of cars so far this year are still running about 4 percent above the level reached in June of 1984.

Average employment for the industry has increased from its low point reached in 1982, bringing back about 200,000 workers. However productivity gains, illustrated by an 18 percent increase in domestic production with only a 10.5 percent employment increase, combined with anticipated increased car imports this year, suggest no return to the peak 1 million worker level of 1978.

As the pace of sales and output accelerated in 1983 and 1984, the financial performance of domestic auto manufacturers improved dramatically. In both 1983 and 1984, the companies earned record nominal profits. In 1984, the "big four" net income was $9.8 billion. In addition to improved volume, the record 1984 profit was the result of a consumer shift to larger, more option-equipped cars with wider profit margins; fixed cost reductions; more stringent control of variable costs; productivity gains; tax loss carry forward; and also import restraints.

Immediate Effects of Import Restraints

What have been the effects of the Japanese auto export restraints?

First, the Japanese auto export restraints have largely achieved their intended purpose -- to provide a breathing space for the

U.S. manufacturers to introduce new, more fuel-efficient products, improve quality and productivity, and restore profitability.

Second, the industry's plans to invest about $80 billion in property, plant, and equipment and $17 billion in product research and development between 1978 and 1985 largely were met. Additionally, U.S. manufacturers reduced their break-even points by slashing fixed costs, so that the previous break-even level of 11.2 million units was reduced to about 8 million units currently.

Third, because of the prolonged U.S. auto sales downturn, the expected benefits of the restraint to U.S. auto producers were not fully realized until early 1983. Similarly, the estimated economic costs of the restraint to U.S. consumers appear to have been modest until the U.S. economy began to recover strongly in 1983.

Fourth, the Department of Commerce estimates that the restraint resulted in additional U.S. production of 700,000 to 1,250,000 automobiles; resulting in an additional 54,000 to 105,500 jobs; and added $1.2 to $2.2 billion to the combined net incomes of the "big three" during the 1983-84 period. The USITC study separately estimated that the restraints resulted in sales of 1.2 million additional domestic autos over the last four years resulting in 44,000 more auto jobs. They also projected additional jobs in auto supplying industries.

Fifth, and here we begin to explore the negative consequences of the restraints, the price effects, although difficult to assess accurately, after early 1983 were, according to most analysts, substantial. It is widely reported that some domestic dealers of Japanese cars have added $500 to as much as $3,000 per car to the manufacturers' suggested retail prices. A USITC study on the effects of the restraints estimated that the prices of domestically produced and imported Japanese cars increased by as much as $660 and $1,340, respectively, as a consequence of the four years of restraint. This resulted in an estimated cost to the U.S. consumer of almost $16 billion over the four years. Other economists using alternative assumptions and methodologies, that allow for the shift in consumer tastes back toward larger cars, have come up with somewhat lower consumer cost estimates -- in the neighborhood of $500 per car. But there is no question that these trade restrictions have been costly to the consumer.

Lastly, an additional negative outcome of the restraints is the economic rents accruing to the Japanese companies. The restraints were intended to assist the U.S. companies, but paradoxically have also increased the profits of their Japanese competitors, which in turn, were plowed back into more innovation and productivity increasing investments that enhance the long-term competitiveness of the Japanese industry. In fact, due to general weakness of world demand for autos and vigorous price competition in the

Japanese home market, our analysis shows that the bulk of Japanese industry auto profits over the recent restraint years has come directly from sales to the U.S. market.

Long-Term Effects of Restraints

Turning now to the long-term effects of the restraints, some recent analysis indicates that, once terminated, they will have only transitory effects on the long run competitive situation in the U.S. market.

A recent staff analysis by the Department of Commerce indicates that as a result of a rise in import competition, sales by traditional domestic manufacturers of U.S. and Canadian-built automobiles could decline from about 7.8 million units in 1984 to 6.4 million units in 1988. Among other things, this analysis assumed complete elimination of the Japanese restraints by April 1, 1986, no rapid movements in fuel prices, and the acceptance at face value of company announcements with respect to captive import plans by U.S. manufacturers and export and U.S. production plans by foreign manufacturers. This study projects that U.S.-production of Japanese designed automobiles to grow from 133,000 to 775,000 units during the same period, partially offsetting this decline.

The Department of Commerce further calculates that these trends could lead to the loss of as many as 91,000 U.S. auto industry and supplier industry jobs by 1988. This loss is in addition to anticipated job reductions due to increases in industry productivity.

In sum, underlying costs and market forces, and what actions the industry and labor, themselves, can take to improve their competitive situation, will continue to determine the future of the industry. During the 1985 to 1989 period, the U.S. auto manufacturers are expected to invest over $50 billion on new products, plant and equipment to improve their international competitiveness. The objective of these industry efforts are to be no less than fully competitive with foreign-based manufacturers in world markets.

VRAs as a Trade Policy Tool

Let me turn now to a second major issue of these hearings, the general use of VRAs as a trade policy tool.

Earlier, I cited the outcome of the USITC injury determination on the 1980 auto industry, import relief case. The Commission's negative determination with respect to injury legally prevented the President from having the opportunity to use Section 201 of the Trade Act of 1974 to restrict imports through tariffs, quotas, tariff-rate quotas or orderly marketing agreements (OMAs).

(The primary difference between OMAs and VRAs is that OMAs are provided as a form of import relief by statute. After a finding of injury by the USITC and their recommendation for the provision of import relief, the President may proclaim his intention to seek OMAs. Furthermore, unilateral restrictions can be resorted to, if for example, an OMA can not be negotiated or is not adhered to by the other country.) The Section 201 process is the U.S. domestic analogue to the Article XIX, escape clause, contained in the General Agreement on Tariffs and Trade (GATT).

Article XIX provides for the temporary suspension of certain GATT obligations if increased imports are the cause of, or threaten to cause, "serious injury" to a competing domestic industry. This article also provides for full notification and consultation with other interested parties and non-discriminatory application on a most-favored-nation basis of any import restricting actions. Exporting countries have the right of retaliation, but in practice, a frequent result is that appropriate compensation, in the form of lowered tariffs in other product areas, is negotiated. Article XIX and other GATT articles also contain procedures for resolving differences between the parties on interpretation or on the factual situation when the escape clause is invoked.

Despite the existence of these provisions and their occasional use, in recent years Article XIX has been largely observed in the breach. The current situation is marked by a proliferation of arrangements, of which the Japanese auto restraint is only one example, that are not covered by existing GATT rules and are referred to as "grey area" restraints. The simplest general explanation for this is that the requirements for invoking Article XIX are too severe.

The history of the negotiation of this section of the GATT suggests that it was designed to discourage excessive use of the escape clause or safeguard actions, by setting a high standard and by exacting, through compensation or retaliation, a cost to the country taking such action. Over time, however, particularly with chronic high unemployment rates among developed countries and sluggishness in the world's economies, the costs of meeting the requirements of Article XIX have been too great. Some have not wanted to or were unable to pay the compensation bill on the increasing volume of trade under "grey area" restraints or desired to prolong the imposition and nature of the restraint well beyond the temporary and digressive standard set in the GATT. Still another reason for the use of selective measures, such as VRAs, is that some have felt that trade frictions might be reduced through negotiated trade restrictions between just two or a few parties.

Unfortunately, these departures from the strictures of Article XIX have proliferated. The informal nature and lack of transparency

of some of these "grey area" actions have made protectionist actions easier to take when they were not really justified. Bilateral VRAs can also result in trade diversion leading other countries to adopt import restrictions.

In the case of carbon steel, for example, the underlying unfair trade problems in the U.S. market resulting from dumping, subsidy, and market restrictions were so pervasive and distortive, that the normal procedures of dealing with unfair trade practices, country by country, product by product, were inadequate. Likewise, resort to the escape clause and paying compensation for problems caused by unfair trade practices was inappropriate. Consequently, along with other actions enunciated in the President's steel program, negotiated surge control arrangements, VRAs, with countries whose exports have increased rapidly, excessively, and unfairly to the detriment of our national economy, were sought and have now been successfully concluded. I note that in the Trade and Tariff Act of 1984, the Congress specifically provided for the enforcement of these arrangements at the U.S. borders.

Differences in structure and circumstances, from one industry to another, will continue to require a case by case analysis over which trade, economic or antitrust policy tool would be most effective in dealing with a specific fair, or unfair, trade situation, that is causing or threatening injury to a domestic industry. Notwithstanding our own use of VRAs, they and other "grey area" measures, such as industry to industry agreements and "forecasts" by the exporting country, in our view must be brought into the GATT system. The United States remains committed to the goal of reaching multilateral agreement on a new comprehensive multilateral safeguards system within the GATT framework. This is an issue of interest to the developed and developing countries alike, and efforts are being made to advance the safeguards negotiations in the context of preparation for the new GATT round.

DATA APPENDIX

Subject	Table
Value of Trade in New Passenger Automobiles	I
Retail Sales for New Passenger Automobiles	II
Value of Trade in Motor Vehicle Parts	III
Value of Trade in Automobile Trucks	IV
U.S. Employment Annual Averages for Motor Vehicles and Equipment Industry	V
U.S. Employment Annual Averages for All Manufacturing Industries	VI
U.S. Employment in All Manufacturing Industries	VII
U.S. Unemployment Rates for Civilian, All Manufacturing, and Auto Manufacturing Industries	VIII
U.S. Unemployment Rates (Monthly) for Auto Manufacturing Industries	IX
All Civilain Employment in Millions	X
Consumer Price Index for New Cars	XI
Producer Price Index for New Cars	XII
Consumer Price Index for All Items	XIII
Producer Price Index for All Items	XIV

Table I

VALUE OF TRADE IN NEW PASSENGER AUTOMOBILES
(in billions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1970	1.373	.456	.114	-1.259
1971	2.737	.929	.124	-2.613
1972	3.111	1.138	.122	-2.989
1973	3.716	1.244	.215	-3.501
1974	4.454	1.686	.347	-4.107
1975	4.198	1.742	.427	-3.771
1976	5.327	2.855	.566	-4.761
1977	6.791	3.860	.637	-6.154
1978	9.583	5.771	.956	-8.627
1979	10.982	6.471	1.323	-9.659
1980	12.877	8.229	.884	-11.993
1981	13.427	9.491	.765	-12.662
1982	14.392	9.608	.517	-13.875
1983	17.459	11.441	.346	-17.113
1984	19.169	12.349	.348	-18.821
1984 JAN TO APR	7.204	4.089	.133	
1985 JAN TO APR	8.722	4.902	.142	

* Except Canada

Source: Department of Commerce

56-201 0 - 86 - 2

Table II

RETAIL SALES OF NEW PASSENGER AUTOMOBILES
(in thousands of Units)

Year	Domestic 1/	Imported 2/	Imports from Japan	Total
1969	8,385	1,044	191	9,429
1970	7,157	1,261	313	8,418
1971	8,263	1,541	552	9,804
1972	8,958	1,592	615	10,550
1973	9,631	1,753	742	11,385
1974	7,332	1,409	597	8,741
1975	7,050	1,580	817	8,630
1976	8,607	1,499	938	10,106
1977	9,104	2,069	1,388	11,174
1978	9,308	1,976	1,337	11,284
1979	8,225	2,304	1,749	10,530
1980	6,578	2,363	1,882	8,941
1981	6,206	2,327	1,859	8,533
1982	5,757	2,223	1,798	7,980
1983	6,795	2,386	1,877	9,182
1984	7,951	2,418	1,906	10,369
1984 Jan to May	3,590	1,006	764	4,526
1985 Jan to May	3,648	1,067	812	4,705

1/ Domestic automobile sales include U.S. and Canadian built automobiles sold in the United States.
2/ Does not include automobiles imported from Canada.

Source: Ward's Automotive Reports

Table III

VALUE OF TRADE IN MOTOR VEHICLE PARTS
(in billions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1970	.571	.164	.952	.381
1971	.750	.213	.942	.192
1972	1.134	.408	1.015	-.199
1973	1.601	.579	1.246	-.355
1974	2.157	.886	1.809	-.349
1975	1.857	.741	2.322	.465
1976	2.801	1.343	2.497	-.305
1977	3.473	1.584	2.543	-.929
1978	4.991	2.480	2.484	-2.507
1979	5.673	2.665	3.156	-2.516
1980	6.027	2.791	3.883	-2.144
1981	4.551	1.822	5.067	.516
1982	4.587	1.822	4.259	-.328
1983	6.029	2.112	3.273	-2.756
1984	8.253	2.940	4.156	-4.097

Data not yet available for 1985

* Except Canada

Source: Department of Commerce

Table IV

VALUE OF TRADE IN AUTOMOBILE TRUCKS 1/
(in millions of $US)

Year	U.S. Imports from the World*	U.S. Imports from Japan	U.S. Exports to the World*	Trade Balance
1970	2.853	.116	172.633	169.780
1971	28.943	26.432	163.575	134.632
1972	117.448	116.594	158.757	41.309
1973	60.863	59.147	202.675	141.812
1974	40.993	40.466	298.533	257.540
1975	5.385	5.160	924.255	918.870
1976	1.093	.894	715.560	714.467
1977	1.048	.955	691.876	690.828
1978	1.828	1.385	919.755	917.927
1979	25.580	25.341	909.577	883.997
1980	375.866	375.726	1,143.118	767.252
1981	1,816.782	1,811.977	1,208.221	-608.561
1982	1,507.934	1,486.753	1,263.000	-244.934
1983	1,763.280	1,755.177	644.049	-1,119.231
1984	2,400.137	2,350.15	475.887	-1,924.250
1984 Jan to May	664.235	663.50	135.098	
1985 Jan to May	1,160.028	1,089.79	159.602	

*Except Canada

1/ Data includes lightweight cab/chasis which were reclassified as unfinished trucks (692.02) during 1980 by the U.S. Customs Service.

Source: Department of Commerce

Table V

U.S. EMPLOYMENT

ANNUAL AVERAGE FOR THE
MOTOR VEHICLES AND EQUIPMENT INDUSTRY
(In Thousands)

	Employment
1972	874.8
1973	976.5
1974	907.7
1975	792.4
1976	881.0
1977	947.3
1978	1004.9
1979	990.4
1980	788.8
1981	783.9
1982	690.0
1983	757.8
1984	860.1

U.S. EMPLOYMENT

MONTHLY FIGURES FOR 1984 AND 1985 YEAR TO DATE
FOR THE MOTOR VEHICLES AND EQUIPMENT INDUSTRY
(In Thousands)

1984	Jan	839
	Feb	848
	Mar	852
	Apr	851
	May	848
	June	853
	July	857
	August	880
	Sept	866
	Oct	869
	Nov	873
	Dec	888
1985	Jan	891
	Feb	876
	Mar	867
	Apr	876 P
	May	876 P

P - Preliminary

Source: Bureau of Labor Statistics

Table VI

U.S. EMPLOYMENT

ANNUAL AVERAGE FOR
ALL MANUFACTURING INDUSTRIES
(In Millions)

	Employment
1972	19.15
1973	20.15
1974	20.08
1975	18.32
1976	19.00
1977	19.68
1978	20.50
1979	21.04
1980	20.29
1981	20.17
1982	18.78
1983	18.50
1984	19.41

Source: Bureau of Labor Statistics

Table VII

U.S. EMPLOYMENT

MONTHLY FIGURES FOR 1984 AND YEAR-TO-DATE 1985
FOR ALL MANUFACTURING INDUSTRIES
(In Millions Seasonally Adjusted)

1984	Jan	19.08
	Feb	19.19
	Mar	19.28
	Apr	19.35
	May	19.39
	Jun	19.45
	Jul	19.51
	Aug	19.54
	Sep	19.48
	Oct	19.54
	Nov	19.55
	Dec	19.60
1985	Jan	19.60
	Feb	19.56
	Mar	19.53
	Apr	19.47 P
	May	19.44 P

P - Preliminary

Source: Bureau of Labor Statistics

Table VIII

UNITED STATES UNEMPLOYMENT
(Percent)

	All Civilian	Manufacturing	Auto Manufacturing
1972	5.6	5.6	4.4
1973	4.9	4.3	2.4
1974	5.6	5.7	9.3
1975	8.5	10.9	16.0
1976	7.7	7.9	6.0
1977	7.0	6.7	3.9
1978	6.0	5.5	4.1
1979	5.8	5.5	7.5
1980	7.1	8.5	20.3
1981	7.6	8.3	14.6
1982	10.8	14.8	23.0
1983	9.6	11.2	12.6
1984	7.2	7.5	7.2
1984 Jan	8.0	8.4	6.4
Feb	7.8	7.5	5.4
Mar	7.8	7.5	5.8
Apr	7.8	7.7	6.3
May	7.5	7.1	8.0
1985 Jan	8.0	8.4	7.9
Feb	7.8	8.2	6.2
Mar	7.5	8.1	6.8
Apr	7.1	8.0	6.9
May	7.0	7.4	7.3

Source: Bureau of Labor Statistics

Table IX

UNITED STATES UNEMPLOYMENT
MONTHLY RATES FOR 1983 AND 1984 AND YEAR-TO-DATE 1985
FOR THE AUTO MANUFACTURING INDUSTRY
(In Percent)

1983	Jan	16.9
	Feb	16.9
	Mar	15.5
	Apr	15.8
	May	14.7
	Jun	13.9
	Jul	10.7
	Aug	10.3
	Sep	11.3
	Oct	10.7
	Nov	9.4
	Dec	5.5
1984	Jan	6.4
	Feb	5.4
	Mar	5.8
	Apr	6.3
	May	8.0
	Jun	7.7
	Jul	6.4
	Aug	8.5
	Sep	10.3
	Oct	8.8
	Nov	6.7
	Dec	4.1
1985	Jan	7.9
	Feb	6.2
	Mar	6.8
	Apr	6.9
	May	7.3

Source: Bureau of Labor Statistics

Table X

All Civilian Employment
(In Millions)

1980	99.303
1981	100.397
1982	99.526
1983	100.834
1984	105.005

Source: Bureau of Labor Statistics

Table XI

CONSUMER PRICE INDEX FOR NEW CARS
1977-1985
(By Quarter)

1977:1	1.399
1977:2	1.412
1977:3	1.430
1977:4	1.475
1978:1	1.501
1978:2	1.523
1978:3	1.552
1978:4	1.575
1979:1	1.612
1979:2	1.653
1979:3	1.678
1979:4	1.696
1980:1	1.743
1980:2	1.778
1980:3	1.815
1980:4	1.834
1981:1	1.842
1981:2	1.894
1981:3	1.922
1981:4	1.950
1982:1	1.957
1982:2	1.970
1982:3	1.985
1982:4	1.989
1983:1	2.012
1983:2	2.013
1983:3	2.022
1983:4	2.058
1984:1	2.073
1984:2	2.074
1984:3	2.083
1984:4	2.110
1985:1	2.131

Table XII

PRODUCER PRICE INDEX FOR NEW CARS
JANUARY, 1977-APRIL, 1985,
(By Month)

1977:1	1.523
1977:2	1.523
1977:3	1.525
1977:4	1.529
1977:5	1.532
1977:6	1.536
1977:7	1.536
1977:8	1.542
1977:9	1.543
1977:10	1.629
1977:11	1.628
1977:12	1.632
1978:1	1.635
1978:2	1.635
1978:3	1.636
1978:4	1.643
1978:5	1.666
1978:6	1.670
1978:7	1.672
1978:8	1.672
1978:9	1.673
1978:10	1.736
1978:11	1.741
1978:12	1.745
1979:1	1.770
1979:2	1.778
1979:3	1.779
1979:4	1.808
1979:5	1.812
1979:6	1.815
1979:7	1.817
1979:8	1.776
1979:9	1.781
1979:10	1.884
1979:11	1.883
1979:12	1.886

PRODUCER PRICE INDEX FOR NEW CARS
JANUARY, 1977-APRIL, 1985,
(By Month)

1980:1	1.917
1980:2	1.901
1980:3	1.904
1980:4	1.956
1980:5	1.943
1980:6	1.945
1980:7	1.987
1980:8	2.003
1980:9	1.924
1980:10	2.084
1980:11	2.089
1980:12	2.073
1981:1	2.098
1981:2	2.102
1981:3	2.084
1981:4	2.136
1981:5	2.161
1981:6	2.170
1981:7	2.171
1981:8	2.166
1981:9	2.084
1981:10	2.272
1981:11	2.273
1981:12	2.279
1982:1	2.286
1982:2	2.225
1982:3	2.225
1982:4	2.225
1982:5	2.250
1982:6	2.275
1982:7	2.286
1982:8	2.295
1982:9	2.171
1982:10	2.337
1982:11	2.337
1982:12	2.341

PRODUCER PRICE INDEX FOR NEW CARS
JANUARY, 1977-APRIL, 1985,
(By Month)

1983:1	2.326
1983:2	2.318
1983:3	2.308
1983:4	2.313
1983:5	2.316
1983:6	2.319
1983:7	2.322
1983:8	2.330
1983:9	2.222
1983:10	2.374
1983:11	2.373
1983:12	2.373
1984:1	2.377
1984:2	2.379
1984:3	2.381
1984:4	2.387
1984:5	2.381
1984:6	2.375
1984:7	2.376
1984:8	2.369
1984:9	2.289
1984:10	2.398
1984:11	2.402
1984:12	2.406
1985:1	2.441
1985:2	2.443
1985:3	2.442
1985:4	2.441

Table XIII

CONSUMER PRICE INDEX FOR ALL ITEMS
1977-1985
(By Quarter)

1977:1	1.773
1977:2	1.804
1977:3	1.829
1977:4	1.856
1978:1	1.888
1978:2	1.931
1978:3	1.976
1978:4	1.022
1979:1	2.072
1979:2	2.140
1979:3	2.208
1979:4	2.278
1980:1	2.368
1980:2	2.448
1980:3	2.493
1980:4	2.564
1981:1	2.633
1981:2	2.689
1981:3	2.764
1981:4	2.809
1982:1	2.835
1982:2	2.873
1982:3	2.924
1982:4	2.934
1983:1	2.937
1983:2	2.968
1983:3	2.999
1983:4	3.030
1984:1	3.069
1984:2	3.097
1984:3	3.125
1984:4	3.153
1985:1	3.178

Table XIV

PRODUCER PRICE INDEX FOR ALL ITEMS
JANUARY, 1977-MARCH, 1985,
(By Month)

1977:1	1.881
1977:2	1.902
1977:3	1.920
1977:4	1.943
1977:5	1.952
1977:6	1.945
1977:7	1.948
1977:8	1.946
1977:9	1.953
1977:10	1.963
1977:11	1.971
1977:12	1.982
1978:1	2.001
1978:2	2.021
1978:3	2.037
1978:4	2.065
1978:5	2.080
1978:6	2.096
1978:7	2.107
1978:8	2.106
1978:9	2.124
1978:10	2.149
1978:11	2.157
1978:12	2.175
1979:1	2.208
1979:2	2.241
1979:3	2.267
1979:4	2.300
1979:5	2.320
1979:6	2.335
1979:7	2.369
1979:8	2.383
1979:9	2.420
1979:10	1.456
1979:11	1.472
1979:12	1.497

PRODUCER PRICE INDEX FOR ALL ITEMS
JANUARY, 1977-MARCH, 1985,
(By Month)

1980:1	2.549
1980:2	2.602
1980:3	2.619
1980:4	2.628
1980:5	2.642
1980:6	2.656
1980:7	2.704
1980:8	2.738
1980:9	2.746
1980:10	2.961
1980:11	2.955
1980:12	2.958
1981:1	2.848
1981:2	2.876
1981:3	2.903
1981:4	2.934
1981:5	2.941
1981:6	2.948
1981:7	2.962
1981:8	2.964
1981:9	2.957
1981:10	2.961
1981:11	2.955
1981:12	2.958
1982:1	2.983
1982:2	2.986
1982:3	2.980
1982:4	2.980
1982:5	2.986
1982:6	2.993
1982:7	3.004
1982:8	3.002
1982:9	2.993
1982:10	2.998
1982:11	3.003
1982:12	3.007

PRODUCER PRICE INDEX FOR ALL ITEMS
JANUARY, 1977-MARCH, 1985,
(By Month)

1983:1	2.999
1983:2	3.009
1983:3	3.006
1983:4	3.006
1983:5	3.015
1983:6	3.024
1983:7	3.032
1983:8	3.047
1983:9	3.053
1983:10	3.060
1983:11	3.055
1983:12	3.061
1984:1	3.080
1984:2	3.089
1984:3	3.110
1984:4	3.113
1984:5	3.115
1984:6	3.113
1984:7	3.119
1984:8	3.107
1984:9	3.093
1984:10	3.094
1984:11	3.104
1984:12	3.099
1985:1	3.098
1985:2	3.092
1985:3	3.087

Representative LUNGREN. Thank you very much, Ambassador, and I do appreciate the fact that you've come here after a long trip from Japan, after working very hard over there. So I hope that I won't belabor the point or keep you here too long, but let me just ask you a couple of questions.

First, of all, you talked about the objectives that were announced with the initial trade restraints. And you indicated that we had breathing space; that there was some investment; that the U.S. manufacturers got their break-even point down, and so forth.

Then you mentioned the two negative points. One is the cost consequences and I think this particular subject has been argued about a great deal. That has been pointed out in editorials around the country, the cost not only to the purchaser of the foreign car, the Japanese car, but the purchaser of the domestiic car, because the competitive influences weren't there.

But the last point you made I thought was an interesting one that I have seen debated a whole lot, and that is the profit margin allowed to the Japanese manufacturers which are then plowed back into their own investment.

Viewing that, which I think is a rather large consequence, overall would we proclaim the idea of restraints a success or a failure?

Mr. SMITH. Well, I think you would have to say that for the immediate time—let's say, the first 3 or 4 years—the restraints served that purpose in my personal judgment. But by the time of the fourth year and had they continued into the fifth year, they would be becoming very costly; not just to the consumer, but to the fact that the—in my view, from what I've been able to understand in my trips to Japan—that the amounts of cash being amassed and profits by the Japanese producers were growing, if you will, faster than the normal expectation and, therefore, they were being plowed back into the R&D cost, inter alia, faster than one would expect and I would have to say that had they been continued beyond where they were, then one could not have judged them or would not have been able to judge them a success.

I'm not 100 percent sure that one would want to qualify any restraint in trade policy terms, a "success." That implies it's a good thing. Most trade officials that I've talked with in my 13 years in trade matters in the Federal Government, say that one takes restraint action with a great deal of reluctance. But there are restraint measures which do, if you will, work if they're done cleanly and simply and definitively provided that they end after a while and they don't become a crutch.

Representative LUNGREN. What would be a determining factor in deciding that they should have been—should be extended a year from their original 3 years, to 4 years? I mean, what kinds of things would you judge appropriate for us to look to. Because you mentioned that, had they gone on any longer, they would have had a net negative effect on the economy.

What things do you look at to suggest that for the period of time we had them there, they were successful. And beyond that, they had lost their usefulness.

Mr. SMITH. First of all, with regard to the increasing cost to the consumer, one could argue that for the first year or so the price

only gradually increased. By the time of the fourth year, the additionality was very clear.

You could go into a Japanese auto dealer here in the United States of Japanese autos and you could see right on top of the suggested manufacturer's list prices a little thing called a dealer's additional auto preparation, or whatever it was, $700. And then there was some other thing put on there; it was just pure quota, quota fee, it was becoming very blatant. And that's a cost—a clear cost that one gets when one gets into quotas. It's called the "economic rent" or the "quota fee" and I think that this was going on rather openly and the costs were increasing to the consumer—particularly over the last 2 years.

The question one has to look at is whether the U.S. automobile industry responded to the opportunity of breathing space. It's clear that they did; it's clear by 1983 or certainly by 1984 that the industry was back on its feet again. And that the—in trade policy terms, there was no need for the restraints to continue; profits were up; production was up; employment was up.

And if you look at the classic criteria of article XIX of the GATT, look through the other side of the telescope, you're only supposed to take restraint action when you have declining employment; declining production; declining profits; and it was quite the other way. Time to get rid of the restraints.

Representative LUNGREN. So it fit the formula.

Mr. SMITH. I'm sorry?

Representative LUNGREN. It fit the formula.

Mr. SMITH. It fit the formula, yes, sir.

Representative LUNGREN. You invited me, very graciously, a few minutes ago, to direct any questions that I might have on your recent trip to Tokyo and rather than bog you down in a lot of details, let me just ask you generally your immediate observations on the relative progress that you believe—or lack of it—being made in our negotiation with Japan on opening its markets on the four United States export sectors.

Mr. SMITH. Well, sir, I guess I'm a frustrated trade negotiator. Seems to me things move at glacial speed.

I think it's safe to say that we had made substantial progress with our Japanese trading partners on the question of telecommunications in the sense of those things which we had to resolve before April 1, dealing with the privatization of NTT and the Telecommunications Reform Act.

Since that time, we have begun a discussion on radio wave matters and things like that dealing with other aspects of telecommunications. Our concern, as I expressed it in Tokyo last week, was that we would not have to go through the same process to handle the question of radios, if you will, that we did in handling the question of other aspects of telecommunications.

In other words, I had hoped that both the Japanese Government and the Japanese industry would have learned from the precedents which Lionel Olmer, and I had set up in dealing with the NTT question so that we could short-circuit or leap-frog over some of these procedural things and get right down to the nitty-gritty of the matter concerning radios, for example.

Right now the jury is still out as to whether that message has been received, much less as to whether the Japanese bureaucracy will respond in the expeditious way that we think they should.

In the electronics sector, there was a great deal of discussion on the semiconductor 301 case brought forward by the Semiconductor Industry Association a week ago last Friday. There were discussions about certifications and tariffs and standards; and there, I would say, the progress is going reasonably well. I think our industry advisers are reasonably satisfied that we are making some progress in the electronics side.

The forest products side, sir, remains the slowest of all because we have asked the Japanese to lower some tariffs on products which we think we are competitive in and which, in our view, are highly protected in Japan and unnecessarily protected in Japan. Until that nut, that tariff nut, is cracked, I think our progress in forest products will be slow.

On the medical and pharmaceutical equipment things, I had left Toyko by the time those discussions were taking place just this past Saturday. Up until that time our discussions had been going reasonably well. Again, we had been concentrating on the issues of certifications, standards, testing, things like that.

And there I would hope that we should be able to make good progress but I think—just the general question of market opening in Japan is a very slow, very tedious process, but one which I think is absolutely necessary in order to reinforce upon our Japanese trading partners that the system, the open-trading system, depends as mush on their being open as it does on our being open.

Representative LUNGREN. Let me ask you a general question.

Is there an appreciation, or recognition, of the level of frustration that's growing in the United States over this? And let me just specifically mention to you, the electronics industry, the high-technology industry, is obviously very important to California as it is to the rest of the world. And I'd always been impressed with representatives of that industry in their seeking of a free trade situation worldwide and being most vociferous among the many industry leaders we have against voluntary restraints in autos and every thing else becasue of the implications for their own industry later on.

I find the frustration level so high in that industry that many in that industry are saying things they didn't say 1 year, 2, 3 years ago, and saying it loudly and often and it indicates to me a tremendous change—maybe not a total change of mind, but certainly a change in attitude, or a change in emphasis, let me put it that way—that is very evident to me. Is there any appreciation for that from the Japanese representatives that you've had the fortune to deal with during your last trip?

Mr. SMITH. Well, sir, I think at the very highest levels of the Japanese Government there is, indeed, an awareness and sensitivity to that. The great question has always been, whether the middle-level bureaucrat understands this.

My fear is that a number of key, middle- and upper-middle-grade bureaucrats within the Japanese ministries think that the great outpouring of concern by the Senate and the House this past spring has, like a floodtide, reached its peak and is now ebbing and that

they don't really have too much to worry about in the future. We have tried to tell them this is an extremely risky—I used the word "risky"—thing for them to assume; I don't think it's true. I think there are real dangers and frustrations here.

With specific regard to the industry you've talked to in California, sir, this came up very much in the electronics discussion. There is something which does not quite jibe correctly. The United States, for example in semiconductors, holds about 50 percent of the European market. And in many places around the world we hold between 40, 60, and 70 percent.

But in Japan, for reasons I still don't understand, we seem to hold anywhere between 9 and 11 percent and have been doing so for almost a decade. Some call it the "worm theory," or the "worm graph." It just stays flat with just a little squiggle here and there.

I think that the frustration of the electronics industries in the United States, which are world-class and highly competitive, is understandable there; and that something isn't right. I don't mean to prejudge anything before the Government now, but something just doesn't seem to strike my Yankee sense correctly here, sir.

Representative LUNGREN. Well, I appreciate that. I just hope that they fully understand that some of the people who are the strongest advocates of free trade and those industries who would fight protectionist-type legislation or voluntary restraints on automobiles, or quotas, or tariff barriers on automobiles, are now beginning to feel very differently because they find it affecting their industries in very severe ways and I can only comment on the pronounced difference that I've seen over just a couple of years. And so I hope they understand that Congress was not just a momentary spasm of concern.

I was one of those who voted against the bill before the House but I can tell you my concern is there and I'm sure that you did your best to inform them of that.

Mr. SMITH. I did, sir.

Representative LUNGREN. I thank you for taking the time to be with us particularly since, as I say, you just came back from Japan and I thank you for your prepared statement.

Now for panel discussion, we would ask Maryann Keller to come forward as well as Robert Crandall.

Mr. Crandall is from the Brookings Institution, and Ms. Maryann Keller is the director and auto analyst of the Vilas-Fischer Associates of New York.

I would ask each of you to make your statements—we have copies of them; we will make them a part of the record. You may proceed as you wish asking Mr. Crandall if he would please go first.

STATEMENT OF ROBERT W. CRANDALL, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. CRANDALL. Thank you, Congressman. It's a pleasure to be here to testify on the effects of the trade protection of the automobile industry during the 1980's.

I have a prepared statement which I'll submit for the record; I'll try to summarize it briefly.

I will begin by issuing the usual disclaimer that what I'm about to say are my own views, not the views of the Brookings Institutions necessarily nor any of the trustees.

About a year ago I published in the Brookings Review which added to a limited number of studies of the effects of the VER's or VRA's, whatever you wish to call them, on Japanese automobile exports to the United States.

I am continuing to work on this issue to some extent though I have not all that much to add to the results of my study of a year ago. We academics work at a more leisurely pace than those people who have to advise portfolio managers.

I will begin my testimony by pointing out that I find it very difficult to accept any theoretical basis for the breathing space agruments for impacted industries in the U.S. economy, particularly an industry the size of the automobile industry, an industry with access to capital markets. It seems to me that most of the arguments that one can make for temporary protection of an industry, do not withstand scrutiny where there is good information being fed to capital markets.

Specifically I, in my prepared statement, refer to two sorts or arguments. One is that there's a necessity, temporarily, to widen profit margins in order to induce investors to invest their scarce savings in the automobile industry or any other impacted industry. If, in fact, it takes Government intervention to artificially raise prices or production in order to induce investors to invest their scarce resources in that industry, it seems to me that we're distorting a market signal which is telling us something; namely, that those savings are better employed elsewhere.

Second, if the argument is that there is necessity for creating temporary cash-flows, it must be suggesting that, in fact, the capital markets are not operating very well to provide those moneys to the companies. I find it hard to believe that the capital markets don't have rather good information about the automobile industry. Perhaps some of the stories about the Chrysler bailout, perhaps, will cast some doubt upon the notion that we have perfect capital markets.

So it seems to me that section 201 protection for the autmobile industry is unwise on a priori grounds.

Second, what I'd like to do is just simply run through what the problems of the auto industry were in 1980–81 when we established—or when President Reagan established—the voluntary export arrangements with the Japanese.

As is usually the case, trade protection of the escape clause 201 variety usually follows a downturn in demand. In almost every case I'm aware of the pressure for this type of trade production occurs when demand is weak. Obviously, automobile demand was extremely weak in 1980. In addition, there was a rising value of the dollar particulary against the yen from its bottom point in 1978–79.

Third, there was the problem of very high unit labor costs due to higher wage rates and lower productivity levels in automobiles in the United States than in Japan.

And, fourth, there was the argument that, in fact, the automobile manufacturers were having a difficult time adjusting their mix

to the new realities of high energy prices following the collapse of the Shah of Iran.

Well, it seems to me none of these problems that were plaguing the automobile industry are the sorts of things that are best addressed through trade protection.

In the first place, if anything, in a period of cyclical downturns, what we want to do is to stimulate demand, not to suppress demand through higher prices caused by trade protection.

Obviously, trade protection is going to do nothing for the value of the dollar. Of course, as an economist, I am somewhat reluctant to offer you theories on what determines the value of the dollar today. But it seems unlikely that one can make a strong case that trade protection is going to depreciate the dollar and, in fact, most theoretical expositions would suggest it's exactly the contrary.

Third, it seems to me that trade protection, the VER's, are obviously adverse to the solution of the problem of excessive labor costs. Excessive labor costs are due to a variety of factors, one of which is the results of collective bargaining every 3 years; another of which is union work rules negotiated either at the natonal level or more typically at the plant level.

There has been an attempt by management to change work practices; change the organization of production, which often involves very difficult decisions. To impose trade protection at a time when the industry's costs are out of line is simply to take the pressure off doing much about those costs. In fact, later on I will suggest that in fact this is exactly what happened.

Finally, it doesn't seem to me that if, in fact, there is a necessity to adjust quickly to higher gasoline prices because of the pressure from imported Japanese cars, many of which are more fuel efficient than our own, that you increase this pressure or you accelerate the pace of adjustment by removing the competitive stimulus from abroad.

Now, if we look at what happened during the period of VER's, it seems to me that it's quite clear that while we can argue about the size of the affects—the direction of the affects, it seems to me, are quite clear.

First, it is obvious that imported Japanese car prices rose substantially.

Second, the prices of U.S. produced models rose substantially, though, there are many industry officials who will dispute that using numbers on a selected number of small Detroit models.

Third, the annual rate of investment in the industry did not accelerate and, in fact, probably slowed.

And then, finally, the downward pressure on workers' wages was actually eased by the restraints.

My results most recently would suggest that the price of Japanese cars was probably raised between 20 and 30 percent over what they would have been in the United States had there been no trade protection.

Now, this is based upon an analysis of list prices of automobiles for a variety of different attributes, plus an adjustment for an increase in the ratio of transaction to list prices. This is an analysis that is very difficult to do because the dimensions of automobiles are constantly changing; the options loading is changing; the mix is

changing; and we have very poor data on the relationship of transactions price to list prices at the dealer showroom.

If 20 to 30 percent is right, this suggests that the VER's raised the price of a Japanese car in the United States between $1,500 and $2,500. Most of us who dabble in this sort of analysis, stop in the dealer showrooms to see what comparable cars are priced at abroad. You will find that in Japan that prices of Japanese Toyota Camrys, Mitsubishi Gallants, and so forth, are typically $2,500 to $4,000 less in Japan than here. The regulatory costs are somewhat lower over there, though, there's not a very large difference, maybe 4 or 5 percent of the value of the car.

So it seems to me quite clear that the trade restraints, by 1984, were adding substantially to the price of imported Japanese cars.

Ambassador Smith earlier referred to the fact that he thought the restraints might have worked through the first 2 years, had become doubtful by the third year and maybe into the fourth year, and certainly did not—should not have been renewed for the fifth year. I think another way to put that conclusion is that for the first 2 years they were largely irrelevant; because the market was so depressed, they had very little effect upon import shares or market prices.

As for the effect on U.S. car prices, my estimate in the Brookings Review article was that VEC's raised U.S. prices in 1983 by $400 per car, and it seemed to be consistent between small and large cars which surprised me somewhat.

Since that time, the gap between what Japanese imports sell for in the United States and what I would have expected them to sell for, has widened substantially—perhaps by $700 or $800 between 1983 and, say, late 1984, the period for which we have the most recent data.

And that would suggest that by 1984 the effect on U.S. cars was substantially greater, maybe as much as $600 to $700 per automobile.

Now, as for investment, we have a difficult problem here because the industry obviously went through a very serious recession in the early 1980's. In the period just before the restraints, real capital spending in the industry was greater than it was for the 4 years during the restriant. That's not unusual; it happens every time import restrictions are placed on the carbon steel industry; every time they're placed on the specially steel industry. One might try to adjust for the downturn in the economy, but even if you do that, you can hardly say that the industry spent substantially more due to the trade restrictions than they otherwise would have.

As for wages, it's quite clear that the automobile companies in 1984 were forced to give back substantial wage increases to their workers because the VEC's pushed their profits to nearly $10 billion after taxes. It was very difficult to go to the United Auto Workers pleading inability to raise wages because of the competitive pressures from aboard when these trade restraints were so enhancing the income statements and balance sheets of the companies.

The real wage rate of autoworkers did fall during the period of the restraints. By 1984, according to Bureau of Labor Statistics data, the premium of total compensation for all autoworkers over

total compensation for the average manufacturing industry worker, fell to around 56 percent, whereas it has been in the high 60's before the imposition of restraints.

As for labor productivity, the other aspect of unit labor costs, it is very difficult to assess the effects of the VEC's because of the tremendous cyclicality of this industry. It is certainly true that since 1982 the industry's productivity has risen substantially. But it is also true that between 1977 and 1982 it dropped precipitously. And the reason for this is largely the business cycle.

We know from the BLS data that the trend rate of productivity growth in the industry since the mid-1970's is scarcely above 2 percent, which is not a stunning rate of increase. What we don't know is whether we're on a different trend line now as a result of decisions made in Detroit in the last few years.

Finally, there is the problem of quality of U.S. produced cars. By the middle of late 1970's, United States automobile executives began to realize that consumers were buying Japanese cars not simply for fuel efficiency but also for reliability and fit and finish. The average quality of American cars had fallen rather substantially relative to Japanese quality over the period of the 1970's.

Unfortunately, data on the quality of cars is rather illusive. The only published sources of data come from either surveys done by people who poll consumers or by Consumer Reports Magazine and in neither of those surveys does one see an improvement in U.S. automobile quality relative to the Japanese in the 1980's.

On the other hand, if decisions made in 1982, 1983, 1984, were to have an impact on quality, it probably wouldn't show up just yet. So we ought to watch what happens in future years.

I conclude that I don't see any reason on a priori grounds to expect trade protection to revive the automobile industry, nor any reason for it to be necessary for the efficient use of resources.

It seems to me that one can hardly argue that the 4 years of trade protection have had a beneficial effect on the U.S. economy, although, they undoubtedly had a beneficial effect upon the stockholders of the largest three automobile companies in the United States, and their workers.

[The prepared statement of Mr. Crandall follows:]

PREPARED STATEMENT OF ROBERT W. CRANDALL*

Mr Chairman and Members of the Committee: It is a pleasure to appear before you today to discuss the impact of trade protection upon the automobile industry and consumers of automobiles.

In the past year, I published an article in The Brookings Review, providing some estimates of the effects of the 1981-84 Japanese voluntary export restraints (VER's). I am here today to expand upon this work and to offer some observations of the lessons that might be learned from this exercise in trade protection.

The Purported Rationale for Temporary Protection. Under our trade laws, industries that are injured by unfair trading tactics -- such as dumping or foreign subsidies -- may petition for the imposition of duties to offset these unfair practices. In the case of the automobile industry, however, there have been no serious allegations of unfair trade practices against the most important exporter of cars to the United States — the Japanese. Rather, in 1980, Ford and the United Autoworkers asked for temporary relief from rising Japanese auto imports under the "escape clause" provision of the trade laws.

---

*The author is a Senior Fellow at The Brookings Institution. The views set forth here are solely those of the author and do not necessarily represent the opinions of the trustees, officers or other staff members of the Brookings Institution.

The escape clause is designed to provide industries that are seriously injured by a sudden rise in imports with the "breathing space" required to reconstitute themselves and to become viable competitors once again. Insulated somewhat from import competition, these industries are supposed to be more likely to assemble the necessary capital resources to modernize and reduce their production costs.

I doubt that the breathing-space theory ever makes sense in a country with developed capital markets, but it certainly has little application to the case of the U.S. automobile industry in the 1980's. Investors can decide if extending debt and equity capital to an established U.S. industry such as automobiles makes long-term economic sense. If it requires an act of government to shield the industry for three to five years so that it may raise prices and thus make investments in it appear sound, these investments should not be made. To use the trade laws to create temporary monopoly profits for the purpose of rescuing troubled industries is not only inconsistent with our antitrust laws, but it distorts the crucial market signals that are warning investors to place their money where it is more socially productive.

If the argument for escape-clause protection is that it allows firms to generate investment funds through artificially enhanced profits, one must ask why such an industry cannot raise investment monies from external capital markets. And more importantly, should

firms so protected be required to reinvest their artificially enhanced cash flows in an industry that most investors believe to be unattractive?

Neither of these arguments for temporary trade protection seems very persuasive for the automobile industry of 1985 nor for the auto industry of 1980, for that matter. As the major U.S. auto producers now compete to buy out billion-dollar electronics and aircraft companies, we may safely deduce that the trade protection of the 1980's has been excessive.

The recent difficulties of the U.S. auto industry

When Ford and the UAW brought their escape-clause suits in 1980, it was widely recognized that the U.S. industry suffered from a number of problems:

1. Depressed new car demand caused by the 1980 recession.
2. A rising value of the dollar.
3. High unit labor costs due to high wage rates and restrictive work rules.
4. The producers' difficulty in adjusting their model mix fully to higher gasoline prices caused by the second (Iranian) oil shock of the 1970's.

Less widely recognized, but certainly as important, was the widening gap in product quality between Japanese and U.S. models. The reliability of U.S. cars had declined precipitously relative to Japanese models in the 1970's.

None of these problems was likely to be solved by trade protection. Recession and the high dollar afflicted many U.S. industries, not just automobiles. Trade protection would not be extended to every other industry that suffered from depressed demand and rising imports.

The labor-cost problems had been developing for a decade. Only a thorough change in industrial relations and some substitution of sophisticated computer-aided equipment for labor could help to solve this problem. Surely, trade protection would only serve to relieve some of the pressure for changes in wage rates and labor practices.

The quality problem was neither new nor unknown in 1980. It had been developing for more than a decade, but it did not attract the attention of automobile executives until excellent Japanese cars began to enter the U.S. at an annual rate in the millions rather than the thousands. Surely, relieving this competitive pressure would only serve to postpone the necessary, but difficult decisions to improve engineering and production practices that contribute to reliability and "fit and finish".

In short, it is difficult to think of a serious long-term rationale for the 1981 VER's negotiated by the President. They were simply a reflection of the political power of an industry and its employees that were so concentrated in a few states of the industrial midwest.

The Effects of the VER's of 1981-85.

None of the above arguments was persuasive in late 1980, a Presidential election year. Nevertheless, soon after he was inaugurated, President Reagan induced the Japanese to limit their exports of automobiles to the U.S. to 1.68 million units per year. This limit was raised to 1.85 million units per year for April 1, 1982 through March 31, 1985.

The effects of the quotas against Japanese exports of automobiles to the United States was quite predictable:

1. Imported Japanese car prices rose sharply as supply contracted.
2. The prices of U.S.-produced models were artificially elevated.
3. The annual rate of investment in the industry slowed.
4. The downward pressure on automobile workers' wages was eased.

In short, the American consumer was forced to pay more for cars in order to increase the economic well-being of the stockholders and employees of U.S. and Japanese automobile companies, their dealers, and their suppliers.

My colleagues and I are presently attempting to estimate the effects of the VER's on the price of Japanese imports and domestic models. We are finding that the list price of Japanese imports rose by approximately 31 percent between the second quarter of 1981 and the second quarter of 1984. Our model predicts a 3 percent decline without the VER's. When we adjust for increasing options loading and a richer mix of imports, we find that list prices rose by about 20 percent over this period compared to a prediction of a decline of 11 percent without VER's. By comparison, the average import value of Japanese small trucks rose only 1 percent during this period and U.S. list prices rose by 7 percent. Of course, these trucks were not subject to a VER.

Given that actual buyer prices rose by more than list prices, it is reasonable to conclude from this evidence that the prices of imported Japanese cars were at least 20 percent higher than they would have been without the VER's and perhaps even more. This suggests a premium to the Japanese producers and their dealers of about $1500 per car by mid-1984.

In my earlier work, I found that U.S. car prices had been elevated by about $400 per car by 1983. By 1984, this would certainly have been greater, given that imported Japanese car prices rose by at least $700

more in 1984 than they would have without VER's. If we assume that U.S. producers raise prices by one-half the increase in imported prices, the domestic price enhancement by 1984 would have been $750 per U.S. model sold.

Capital investment in the U.S. automobile industry fell in 1982 and 1983, but it rose to a record high $5.3 billion (1972$) in 1984. For the four years, 1981-84, total capital spending in the industry was $16.2 billion (1972$), a slight decline from the total of $17.1 billion (1972$) during the four years prior to the VER's. The breathing space may have had salutary effects upon profits and the industry's pulmonary function, but it had little apparent effect upon investment.

Nor did the VER's find the industry greatly reducing labor rates. The average hourly compensation of automobile workers was compressed by the concessions granted by the Big Three in 1979-82, but Ford and General Motros were forced to sign a relatively expensive wage agreement in 1984 -- a year in which the protected Big Three automakers reported nearly $10 billion in aftertax profits. Total compensation for autoworkers rose from $16.29 per hour in 1980 to $14.94 per hour in 1984, a rise of 22.4 percent. This resulted in a minor reduction of real wages since the Consumer Price Index rose by 26.0 percent in the same period.

There is some evidence of a surge in auto industry productivity since 1982, but it is difficult to ascribe this to trade protection. Labor productivity fell between 1977 and 1982. Its recovery since 1982

appears to be little more than a cyclical return to a modest secular trend in productivity growth of about 2 percent per year.

Finally, the annual compilations of repair frequency by Consumer Reports shows no narrowing of the reliability gap between U.S. and Japanese cars. Japanese cars remain consistently close to the best rating recorded by Consumer Reports while the U.S. models hover near the bottom of the ratings. Ford shows some evidence of progress, but not Chrsyler and General Motors.

Conclusion.

There is little evidence that the VER's contributed much to the competitiveness of the U.S. automobile industry. They may have raised U.S. automobile employment by about 50,000 in 1983 and 1984, but they probably had the opposite effect upon employemtn in exporting industries. There is no doubt that the VER's added as much as $3 billion to the profits of Japanese automobile companies and their dealers in 1984. Moreover, they contributed between $3.2 billion and $6.0 billion to the workers and the before-tax profits of U.S. companies in 1984. These "benefits" were simply a tax on U.S. car buyers who paid $11,000 to $12,000 in 1984 for a Camry that sold for $6,000 to $7,000 in Japan.

Representative LUNGREN. Thank you very much. Our next panelist is Maryann Keller. We ask you to proceed as you wish.

STATEMENT OF MARYANN N. KELLER, DIRECTOR AND AUTO ANALYST, VILAS-FISCHER ASSOCIATES, LTD., NEW YORK, NY

Ms. KELLER. Thank you, Congressman Lungren.

Four or five years ago—I appeared before several committees in Congress, as the question of protection of the auto industry was studied. And at that time I appeared as a free trader. I would have to say that today I appear with a pragmatic view of the industry.

I've been a student of the auto industry for 14 years and during that time have advised my clients on investments in auto stocks.

I would like to address the subject of protectionism from an industry perspective. In contrast with the other panelists this afternoon, who have emphasized only the issue of whether or not the industry deserved protection and whether the VRA was the correct approach.

In my opinion, the VRA exaggerated the auto industry's problems; it did nothing to help the auto industry. And today the auto industry is probably facing a more competitive and tougher world than it did in 1980.

Previous panelists have cited the benefits to the American auto industry from the VRA—higher prices, higher profits, a benign competitive environment, which, they say, lulled workers and management into paying themselves high wages and excessive bonuses. There is truth in those conclusions.

I think that Mr. Smith began a very good line of commentary when he mentioned the benefit to the Japanese from the VRA. I would like to emphasize that subject.

In my prepared statement I wrote:

> The United States is Japan's only profitable market. And record earnings were achieved under quotas as Japanese auto makers raised prices, shifted their export mix to more expensive cars and benefits from stronger dollar that propelled their earnings. It is common knowledge in Japan that industry earnings are equal to the profits in the United States less losses in Europe and Japan. Toyota is the only auto company that makes money in its home market. Exports to Asia and the Middle East are essentially break-even.
>
> The record profits earned in the United States have allowed cut-throat competition in their local market, forced the Japanese to improve their drive trains and automotive technology in general to diversify their product lines and to install flexible manufacturing systems in assembly plants to permit quick response to demand shifts in the marketplace.
>
> Prior to 1981 Japanese engines and drive trains were poor. But today Japanese four and six-cylinder engines are the best in the world.
>
> An example of both the diversity of product and flexibility of manufacturing systems is evidenced by the fact that in 1974 in Japan, Toyotas nine models recorded roughly 1 million sales, whereas in 1984, 19 models produced 1.27 million sales for Toyota.
>
> The acceleration of the product shift into mid-size and specialty cars has made the Japanese a greater threat in market segments traditionally held by domestic manufacturers.

Only 1 million of the 2.4 million cars exported to the United States this year will be low-end subcompacts, and of those, 30 percent will be the captive imports of General Motors and Chrysler.

All other Japanese cars fit into various categories of sporty, personal compact, and mid-sized cars.

And finally, the VRA alerted the Japanese to an end of unchallenged free trade in automobiles. This caused the shift in strategy from the export of fully built cars to the export of so-called kits. We refer to kits in the United States as locally assembled cars, but in reality over 50 percent of the high-value-added components are imported from Japan and represent the next logical step to higher export earnings for the Japanese auto companies. In fact, local assembly will increase our trade deficit with Japan in automobiles and reduce the United States employment unless local content is required.

The auto industry in the U.S. is a long leadtime industry. A typical product cycle is 5 years. The VRA was in effect for 4 years. So one should not expect much product change during the protectionist period itself.

The auto industry was beset by a management that was reluctant to admit its problems, and in fact in 1980 and 1981 management were only just admitting that they had cost and quality problems. At this time they may have even greater problems confronting them as a result of the VRA.

Recently, the Department of Commerce, in a letter to NHTSA with respect to easing CAFE standards, made projections which I consider to be rather amazing. They estimated total sales in the United States at 11.2 million in 1988. They projected that imports would be 4 million, or 36.3 percent of the car market that year.

They also projected that the United States-assembled Japanese cars would claim another roughly 7 percent of the market, or 775,000 units.

This would leave the U.S. companies with sales of 6.36 million, or only 56.8 percent of the market.

Even though the Department of Commerce projects an increase total sales of 800,000 units between 1984 and 1988, they project a decrease of 1.5 million units of sales of U.S. cars and employment losses of 90,000 by 1988.

Indirectly, this study also indicated something else that is very important about the U.S. car market. It essentially projects that sales of foreign brands are a function of the supply of foreign brand cars. In other words, they project the total market, then estimate availability of foreign cars. The residual number is the domestic auto companies' share.

It is a fact that the current car-buying generation has been reared on imports, has no prejudice against their purchase and believes them to be superior products in spite of their higher prices.

Some market statistics are rather frightening. They show that the median age buyer of a Japanese automobile is 35, and his median income is $37,500, and this compares to a median age of 46 years old and a median income of $35,000 for a typical domestic car buyer. The purchaser of a U.S. car is more than 10 years older and only makes the same amount of money.

There is little brand loyalty in today's market, and car buyers are increasingly demanding specialized, personalized vehicles which ideally suit the Japanese flexible manufacturing systems. There is still a $2,500 cost disadvantage over the Japanese, partly caused by Government policies which overvalued the dollar, and it

is absolutely impossible for a domestic manufacturer to supply a $6,000 subcompact given the present cost structure.

I would like to point to the enormous profits earned by the Japanese manufacturers in the United States. The Japanese are using some of this income to increase its local assembly capacity. So far five Japanese auto companies have come here—Toyota with General Motors, Honda, Nissan, Mitsubishi, and Mazda. Sometime later this year Toyota will announce it is coming by itself.

These plants have a very low level of local content and are therefore, able to retain most of the cost benefits of Japanese production. Their factories are brand new, their work force has no seniority-linked wages and benefits. They bear none of the burden of retirement or pension benefits that are a fact of life for the American auto companies. The States in which they have located have given them special tax treatment and incentives.

Since all high value-added components are brought in from Japan, most of the costs are still denominated in yen. These are incredibly productive facilities, and it has been estimated that Honda, for instance, in Marysville, OH, has less than a $500 cost penalty from having come to the United States.

Now, I should point out again that for each car produced in this manner is not employing the same number of workers or producing the same amount of economic impact as an automobile built by one of the U.S. companies. The United States earnings of the Japanese have encouraged them to come here and establish a second wave of potential share increases to further their growth at the expense of domestic companies.

The U.S. industry has invested a great deal in facilities tooling and equipment since the late 1970's. Capital spending as the previous witness suggested dropped in the early 1900's. However, the pace of investment slowed because of financial constraints in 1980, 1981, and 1982. Automakers have also learned to spend money a little bit more effectively, so that each dollar is buying a bit more today than it did before. Criticism that automakers have not invested enough or slowed investment during the quota period suggests a lack of knowledge about the industry.

Finally, the question is whether or not the investment was made correctly. Many observers point to the increase in the number of brand new highly automated factories in the United States. For example, GM opened a few last year, has several more to open this year. They use this as evidence that the industry has modernized and is capable of competing.

Unfortunately, even the most modern U.S. plant depends upon high-speed, high-volume output of a single model, and these may in fact be dinosaurs of the automotive age. They depend upon conveyor belt Robogate systems, and they are certainly not flexible in terms of what the Japanese production system is today.

It might mean that the U.S. industry is going to have to respond with yet another wave of capital spending in the future to accommodate what is increasingly a fragmented car market.

I appreciate that trade policy is not a black and white situation. I have been a critic of the American auto industry and its management for many years, I now find myself in a position of having

sympathy for them because the quota system created a far more competitive situation than they faced a few years ago.

Perhaps trade policymakers in the future might look a little bit more realistically at the potential effects on the industry they are attempting to protect and on the industry that is being kept at bay. In this particular instance the Japanese auto industry has, in fact, benefitted and I am not sure that I can find permanent benefit in the American auto industry as a result of short-term protection. The auto industry is a long leadtime industry with a 5-year product development cycle and a 7-year product cycle. One would hope future policymakers would understand this.

I offer my own suggestion with respect to potential or possible trade policy. It would have been better to permit a free market in all cars priced under $6,500 and all cars priced over $20,000 and to have imposed a high tariff or high local content for cars that fell into the middle range. It seems to me that that kind of proposal would have ensured the availability of affordable cars for all levels of consumers, including lower income consumers, while at the same time offering some degree of assistance for the American industry.

[The prepared statement of Ms. Keller follows:]

Prepared Statement of Maryann N. Keller

The protection of the U. S. auto industry which began in 1981 was an ineffective solution to the complex task of improving the competitiveness of domestic automakers relative to the Japanese. Although there has been visible progress in product quality and productivity and costs, the voluntary restraint agreement (VRA) also produced a more formidable Japanese industry. Progress in the U. S. was matched or exceeded by the Japanese during the last four years so that our industry still faces the identical problems it confronted in 1980.

It appears that in 1981 we sought a simple, temporary program that accommodated protectionists and free traders alike. The consequences of protectionism in the United States were predictable and included: 1) virtual elimination of the low priced subcompact car; 2) temporary recovery of market share by U. S. companies; 3) high prices to consumers caused by lack of competition in the market place; and 4) record profits reported by U. S. automakers in 1984. We rarely, however, analyze the consequences of the VRA on the Japanese. The United States is Japan's only profitable market, and record earnings were achieved under quotas as Japanese automakers raised prices, shifted their export mix to more expensive cars and benefited from the strong dollar. It is common knowledge in Japan that industry earnings are equal to profits in the United States less losses in Europe and Japan. Exports to Asia and the Middle East are essentially breakeven. Record profits in the United States have allowed cutthroat competition in the local market, which forced the Japanese to improve drivetrains and automotive technology in general, to diversify their product lines and to install flexible manufacturing systems in assembly plants to permit quick response to demand shifts in the marketplace.

Prior to 1981, Japanese engines and drivetrains were poor, but today Japanese 4 and 6 cylinder engines are the best in the world. An example of both the diversity of product and flexibility of manufacturing systems is evidenced by the fact that in 1974 in Japan Toyota's 9 models recorded 1.07 million sales, whereas in 1984, 19 models produced 1.27 million sales. The acceleration of the product shift into mid-size and specialty cars has made the Japanese a greater threat in market segments traditionally held by domestic manufacturers. For example, only 1 million of 2.4 million cars exported to the U. S. this year will be low-end subcompacts and, of those, 30% are the captive imports of General Motors and Chrysler. All other Japanese cars fit into various categories of sporty, personal, compact and mid-sized cars. Finally, the VRA alerted the Japanese to the end of unchallenged free trade in automobiles. This caused a shift in strategy from the export of fully built cars to the export of kits. We refer to the kits as locally assembled cars, but in reality, over 50% of the high value added components are imported from Japan and represent the next logical step to higher export earnings. In fact, local assembly will increase our trade deficit with Japan.

The four-year volume restrictions caused the American consumer to pay an extraordinary price which not only produced some temporary benefit to the U. S. automakers, but also subsidized another transformation within the Japanese auto industry.

We are now faced with the question of whether or not U. S. manufacturers can compete in a free trade environment. The answer is no, they cannot. In April the Department of Commerce projected that imports could reach 4.0 million or 36.3% of projected total sales of 11.2 million by 1988. U. S. assembled Japanese cars could claim another 6.9% of the market at 775,000 units, which would leave U. S. companies with sales of 6.36 million, only 56.8% of the market. Even though the Department of Commerce projects an increase in total sales of 800,000 units, they project a decrease of almost 1.5 million units in sales of U. S. cars. Employment losses could exceed 90,000 by 1988 from this shift.

The Department of Commerce study indirectly admits something very important about the U. S. car market. It projects that sales of foreign sourced cars are a function of supply and that U. S. manufacturers' volume is the residual of total sales less foreign brand cars. The current car buying generation has been reared on imports and has no prejudice against their purchase. Recent statistics show that the median age of a Japanese car buyer is 35 and his income is $37,480. This compares to a median age of 46 and median income of $35,310 for the typical domestic car buyer. There is little brand loyalty in today's market, and car buyers are increasingly demanding specialized, personalized vehicles, which suits Japanese flexible manufacturing systems perfectly.

U. S. automakers still bear a $2,500 cost disadvantage over the Japanese. Part of this reflects currency, but the greater part of the cost difference reflects the basic structure of the U. S. industry. It is impossible for a domestic manufacturer to supply a $6,000 subcompact car given the present cost structure.

The most recent threat to U. S. producers is local assembly by the Japanese. By 1990 there will probably be 1.4 to 1.5 million units of Japanese assembly capacity in the United States. Because of the low level of local content, high productivity of these new plants compared to existing U. S. factories and labor concessions, the Japanese have been able to retain virtually all of their cost advantage in coming here. The fact that the Japanese are at least a quarter of a century away from having to pay pensions to retired workers, which currently adds several hundred dollars to the average U. S. car, demonstrates just one aspect of their competitiveness in the U. S. as new assemblers.

Some industry observers might be tempted to point to record domestic capital spending of the last 6 years and the new assembly plants as evidence of progress. Unfortunately, even the most modern U. S. plant depends upon high speed and high volume output of a single model. These may be the last of the conveyor belt "Robogate" plants. They cannot produce diversified models on a single line, so

the U. S. auto industry may, in fact, be facing another capital investment surge in the near future to respond to an increasingly selective consumer. Because of intensifying competition, the U. S. auto industry may not have the capital necessary to accommodate short production runs and faster product cycles which, in Japan, are now four years compared to about six to seven years in the United States.

So far, the government's efforts to formulate automotive trade policies have failed to balance four critical objectives. It has been difficult to ensure affordable automobiles for all consumers and maintain an open structure in world trade while simultaneously addressing concerns about the health of our financial and economic system and about the viability of the auto industry.

Free trade in automobiles is ideal for ensuring maximum variety of product covering a broad price range. It is also the underpinning for dynamic world trade.

However, free trade is not the best guarantee for bolstering the U. S. economic system and the domestic automakers under current competitive circumstances. According to the Industrial Bank of Japan, a continuation of present trade structure will produce a cumulative trade surplus of $400 billion for Japan between 1983 and 1990. Of this total, approximately 20% will be derived from trade in autos. Such a massive shift of wealth could have more profound consequences on world economics than the emergence of OPEC in the 1970's.

The appropriate automotive trade policy that addresses each of these issues has to incorporate aspects of free trade and protection to satisfy consumers, industry and government. The trade could exist for all cars priced below $6,500 for the average equipped vehicle. This would guarantee enough product to satisfy the transportation needs of lower income consumers. It would not impede the captive import plans by U. S. companies and would probably result in fast price cuts on cars now selling for $7,000 or so. I'm confident that the Japanese will bring in the ultimate high-tech small car for less than $6,500. Free trade could also be

permitted for automobiles that retail for more than $20,000. Periodically, price levels could be adjusted in keeping with changes in the Consumer Price Index.

For the broad range of cars priced between $6,500 and $20,000, a dual system of a 25% tariff on imports and 60% local content on domestically assembled cars, excluding direct labor costs, could be enacted. Japanese automakers would have to decide whether direct exports or local production maximize profits and volume. Competition would be maintained because the Japanese would continue to improve their products, bring down costs, and probably elect to expand local capacity.

In conclusion, let me state again that our auto trade policy has to balance our national interests with those of the consumer and the auto industry within the context of a sound economic framework. The proposal which I have offered is undoubtedly flawed in some ways, but it more fairly balances the interests of all parties than does either a temporary high tariff or volume based quotas which have only exacerbated problems. I hope that in the future trade policy measures are undertaken with more understanding and sensitivity than was the quota system. The auto industry may have needed protection in 1981, but the means to bolster our industry should not have simultaneously enhanced the competition. We are probably no better today than we were in 1981 relative to the Japanese and conceivably we are farther behind.

Representative LUNGREN. Thank you very much.

Mr. Crandall, you have pretty well outlined your belief in the failure, as you see it, of the voluntary restraint policy.

Let me ask this; Has there been an example of where voluntary restraints have worked?

Mr. CRANDALL. Well, I don't know of any where you could prove that in fact an industry—that an industry has rebounded that would not otherwise have rebounded or which was able to survive without trade protection because of a short burst of trade protection.

I happen to follow the steel industry rather closely, and clearly it has not worked there. The steel companies today are in as deep trouble as they were when we first started down this road of attempting to protect them.

Representative LUNGREN. Is the breathing space argument an illusory one? I ask this question because a lot of us here in the Congress like to think ourselves as free traders, yet we have a number of industries that come to us and say: Look, we just need a little bit of time. We made mistakes in the past. There are also some trade problems with our foreign competitors, and as a result, we know that you don't like the idea of trade protectionism, but just give us some breathing space. Give us some time to assemble

our capital, reinvest it, and that is all we will need, and we will be in a stronger position thereafter.

Mr. CRANDALL. Well, it seems to me what they are telling you is that people who advise, decisionmakers in the private capital markets don't believe them and as a result they must come to the Congress. The Congress must then have some reason for believing there are benefits external to that industry from the trade protection.

For instance, I think you can make a case that because the automobile industry is so concentrated in the industrial Middle West, there are neighborhood effects upon other types of enterprises—everything from drug stores to parts suppliers in that region—that might justify some temporary trade protection, or something to alleviate the suffering in those regions.

If it is spread more evenly around the country, the neighborhood effects are probably less important.

Representative LUNGREN. Ms. Keller, as a Wall Street analyst, do you see the U.S. auto industry as a good long-term investment?

Ms. KELLER. Do I think they are good long-term investment? No.

The auto industry stocks are cyclical, and the stocks rise and fall largely in response to a belief about trends in the overall economy. The auto stocks, to give you an example, began to recover in price in the spring of 1982, and that is largely because of the cyclical belief that 1983 would be a better year than 1982 and 1984 a better year than 1983. But no one invests in the auto stocks for the long term.

I would also point out that there is another interesting phenomenon taking place on Wall Street among most analysts, including myself. We no longer approach investing in the auto industry as a domestics only subject. Investing in the auto industry is now done on a global basis, and all of us recommend the stocks of foreign auto companies as easily and quickly as we would recommend the stocks of GM, Ford, and Chrysler. And it is not unusual for an analyst today to give you estimates on Honda, Toyota, GM, Ford, Chrysler, Volvo, Jaguar, Daimler-Benz, you name it. It is a global industry from an investment standpoint as well.

Representative LUNGREN. So, precisely are you then saying that because we have a global auto industry, U.S. efforts to create certain niches of protectionism here are doomed to failure?

Ms. KELLER. I don't see what being a global industry from an investors viewpoint has to do with protectionism. I think that VRA was a miserable failure because it did not protect the auto industry—it aided the competition. I think that there is a reluctance in Washington to admit that an industry needs to have some sort of protection. Because of the free trade basis in Washington most industries seek temporary relief, because that is the only palatable alterative.

But as far as I am concerned, VRA did not do its job. Now, we might be able to criticize the auto company managements and say that they, too, could have done more, and some of the incentive for them to have done more was removed by quotas. That is the age-old argument against protectionism. Maybe there is some truth to that which is why I suggested a multifaceted policy that addresses the needs of consumers, industry, and government.

Representative LUNGREN. Ms. Keller, you mentioned that you used to come here as a free trader; now you call yourself a pragmatist and you indicate that free trade in automobiles is ideal for ensuring maximum variety of products covering a broad price range, it is also the underpinning for dynamic world trade.

On the other hand, you say free trade is not the best guarantee of bolstering the U.S. economic system and the domestic automakers under current competitive circumstances. Why not?

Ms. KELLER. I think it is ideal if we had free trade, but the fact of the matter is we don't.

The last two witnesses were here talking about the fact that they are arguing with the Japanese on minutae in telecommunications, and there is not free trade with Japan in most goods.

Representative LUNGREN. I understand that. I guess my question is, Does it serve our purpose to take a product that is being produced by the Japanese which is basically being purchased because of quality and price?

At least that is my observation. I come from the State of California, where over 50 percent of all the cars sold are foreign made, and I have yet to see anybody handcuffed and blindfolded and forced into a Honda dealership to buy a car. My observation has been that they go in voluntarily and they buy these cars, contrary to what it was when I was a kid growing up, where you wouldn't be caught dead buying a foreign car.

Even if you were a kid and you had toys, you remember you used to have toys and they would be made in Japan or made somewhere else, and you would look on the inside to see if you could see the Hamms beer can imprint because they would take scrap metal from the United States from various things and they would paint them on the outside but not on the inside. That was our vision of what we got from Japan.

Things have changed tremendously in a generation. Today you look for a Japanese auto and decide to purchase it because of quality and price.

Ms. KELLER. Certainly—and product specialization.

Representative LUNGREN. Is there something we ought to do as far as United States Government policy is concerned to punish, in a sense, the Japanese auto industry because of trade restrictions in other industries?

Ms. KELLER. You are asking me whether you should use the auto industry——

Representative LUNGREN. Well, my question is—you said there is not free trade. I posed that question to you about free trade, and you say we don't have free trade. What I am saying is: Are the consequences of the automobile industry in the United States the result of free trade or are they the result of some artificial restraints created in places around the world?

Because if, in fact, the consequences of United States market penetration by the Japanese are not the result of improper trade practices, does it serve the purpose of the United States to try and impact the Japanese penetration because the Japanese Government is condoning, allowing, participating in improper trade practices in other industries?

Ms. KELLER. You are asking why did the problems in the American auto industry arise. I'm not sure we have time to address all

the reasons but it is too simplistic to conclude that because the auto industry got in trouble it deserves to be punished. I would certainly point out the impact of regulation during the 1960's and 1970's of adding costs and shifting capital investment toward meeting a variety of standards, as well as the 1973-74 and 1980 energy crisis which caught the industry by surprise. Do we penalize an industry because a nation has no energy policy and now must other foreign capital to pay for budget deficit with, a strong dollar?

I will admit that the auto industry itself was rather—was totally neglectful and unresponsive to the consumers' needs, and they are still facing some of those problems today.

I think there is a somewhat broader question, though, and that is: Can you let the auto industry just continue to slip away?

Now, as far as using the auto industry as a cudgel against the Japanese, I think you have to appreciate that they protect the markets in which they are inefficient, like their auto industry after World War II. The bulk of Japanese corporate earnings are derived from exports. I think there is a question, and should be a concern, about the potential loss of the auto industry. We have lost the consumer electronics industry to the Japanese. They have taken away our television industry—and I don't think the analogy between the U.S. auto industry and the former U.S. television industry is all that bad. Exactly the same thing is happening in autos—just quotas, then more efficient local assembly, finally the elimination of native producers.

Maybe we can dismiss the television industry, but I am not sure that we can, as national policy, just allow the auto industry to disappear.

Mr. CRANDALL. Let me just answer that briefly, if I might.

Representative LUNGREN. Yes.

Mr. CRANDALL. There certainly have been no allegations, no serious allegations, that the Japanese preeminence in this industry derives from all sorts of unfair trading practices, as is the case in some other industries, nor is there any evidence that the reason for the imposition of the VER's in 1981 or their renewal in 1984 had anything to do with using this as a potential lever against the Japanese for forest products or semiconductors.

In fact, promises were made in 1980, which just happened to be a Presidential election year, and they were renewed in 1984, which also happened to be a Presidential election year.

The decision was made because of electoral politics in the industrial Midwest, not as a means of trying to exert a leverage against the Japanese to open up other markets.

If you did try to use it as a lever, it becomes very difficult because once trade protection is imposed for the benefit of one industry, it is difficult to induce them or their elected representatives to give that up simply because you have obtained greater access for another industry.

Representative LUNGREN. As a Member of Congress, I can appreciate that.

Mr. Crandall, since these voluntary restraints have proven to be so profitable to the large Japanese auto makers, do you anticipate pressures by those large auto makers to continue restrictions on exports to the United States?

Mr. CRANDALL. It's very hard to read that, and maybe Ms. Keller has a different reading from mine, but my reading is that some of them would have liked them continued, but surprisingly, the largest one, Toyota, was, at best, ambivalent and maybe in favor of eliminating the quotas altogether. As it turned out, when the quotes were negotiated by Miti, absent pressure from Washington, Toyota got the short end of the week and got a very small increase in its quota. But I have the feeling from Toyota that they feel that they are in a very good position to expand their world market share and that they are in favor of free trade. In a situation of managed trade, they're willing to go out to the United States, as Ms. Keller suggested they might do, with another plant, and even perhaps to Europe to produce cars now.

Representative LUNGREN. Thank you. There are a lot of other questions I could ask, but I've got another panel going, and I know, Mr. Crandall, you have some travel plans yet to keep, as well. I thank both of you for appearing before us.

Next I would ask Mr. Gary Clyde Hufbauer, senior fellow at the Institute for International Economics, and Mr. Robert C. Angel, president of Angel Associates, Inc., and former president of the Japan Economic Institute of America, to come forward.

Thank you both for appearing, and I would ask Mr. Hufbauer to go first, then followed by Mr. Angel, and your prepared statements will be made a part of the record in their entirety, and you may proceed as you wish, Mr. Hufbauer.

STATEMENT OF GARY CLYDE HUFBAUER, SENIOR FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. HUFBAUER. Congressman Lungren, thank you very much for inviting me to testify at this hearing. I would like to briefly summarize the key points in my prepared statement.

First, I believe we are in a lull in a long espisode of automobile protection. The VRA, as you know, has been replaced by VER, which is administered entirely by the Japanese and is somewhat more liberal; however, if the United States continues to practice trade policy as usual, I think it is very likely that we will return to tighter restrictions once the automotive cycle, turns down and competition from Korea, Europe, and Japan heat up.

Second, the exchange rate is often mentioned as a leading source of the industry's distress. The overvalued dollar—to the extent of 40 percent on a trade-weighted basis, and at least that much and probably a great deal more with respect to Japan—is indeed a major cause of the auto industry's recent troubles. However, two misleading conclusions might be drawn from this observation about overvalued exchange rates, and I would caution against drawing either of them.

The first misleading conclusion is that the auto industry should receive special protection until the exchange rate situation is corrected. I think that conclusion is misleading because it would shift the exchange rate burden to other industries, both on the export side and on the import side, while giving preferential treatment to an industry that is politically powerful.

The second misleading conclusion drawn from the exchange rate situtation is that, once the dollar returns to a more normal level, the auto industry will again regain its competitive strength. Experience in a number of countries—summarized in a volume that will soon be published by the Institute for International Economics—indicates that troubled industries are rarely rescued by the reversal of an overvalued exchange rate.

As one example, the German deutsche mark is significantly undervalued today, yet the list of troubled industries in Germany in 1985 reads much the same as it did in the 1970's and even in the 1960's.

Turning to the U.S. auto industry, it is burdened, by wage rates well above the manufacturing average in the United States, some 60 to 70 percent above the average. This differential is not likely to disappear in the next few years. In addition to saying high wages, the industry does not have as enviable an innovation record as its Japanese competitors.

Suppose I am correct that the industry's long-term problems will persist long after the exchange rate overvaluation is corrected, and that extreme pressure for quantitative restraints will return, once auto sales go into a cyclical downturn. If that's correct, what should we do?

My policy recommendations for this industry parallel the general approach that we at the Institute have been advocating for range of troubled industries.

Let me just outline the highlights of the approach.

First, the United States should auction quota permits for the entry of foreign autos into the U.S. market. The quota auction would replace the VRA/VER type approach; it would recapture the rents from the Japanese auto producers; and it would put those rents where they belong, in the U.S. Treasury. That's key element No. 1.

Second, the quota auction money would be earmarked for a sensible program designed to assist the departure of workers from the automative industry. The program would provide substantially more meaningful benefits than the moribund Trade Adjustment Assistance Program or the Job Training Partnership Act.

Incidentally, let me mention that far more workers will leave the auto industry in the next 5 or 15 years on account of productivity growth, with robotics and all that, than on account of import pressure, no matter what we do on the import side.

As workers leave the industry, the quotas offered at auction would be enlarged. This, of course, would drive down the unit value of quota permits. Eventually, the permits would fetch nothing in the market and the industry would be liberalized.

This liberalization plan would be undertaken in the context of similar liberalization plans by Europe, which is very restrictive on automotive imports, and by Canada, Japan, and other major trading countries.

As novel and radical as this approach may seem, some of the elements have gained a degree of respectability since we at the Institute began discussing them 2 years ago. Last week, the ITC picked up the idea of a quota auction in its escape clause recommenda-

tions for footwear. The idea of dedicating the revenues has yet to receive any official blessing in this country.

In any event, to deal with the growing problem of special protection implemented by quantitative restraints which now cover quite a wide range of imports, I think the time has come for novel solutions. Thank you.

[The prepared statement of Mr. Hufbauer, together with the case study on automobiles referred to, follows:]

Prepared Statement of Gary Clyde Hufbauer

1. As part of a larger study on domestic adjustment and international trade,[1] my colleagues and I have surveyed conditions in the U.S. automobile industry. Appended to this testimony is a preliminary version of our case study on automobiles.

2. The history of US restraints on Japanese auto exports began with the International Trade Commission's decision on the "escape clause" petition brought by the United Auto Workers (UAW) and Ford, on 12 June 1980. In a split decision, three to two, the Commissioners found that "the maximum potential loss to US producers resulting from declining consumption was greater in the period January 1979-June 1980 than that resulting from increased import penetration."[2]

3. Although the escape clause petition failed, continued import pressure on the US market, together with little improvement in auto sales during late 1980 and early 1981, and the precarious financial position of the large US automakers, led to renewed calls for import restraints. These calls prompted the

---

1. The following publications by the Institute for International Economics will result from the adjustment study: a monograph titled Trade Policy for Troubled Industries, authored by Hufbauer and Rosen, to be published in 1985; a casebook titled Case Studies in Special Protection, authored by Hufbauer, Berliner, and Elliott, to be published in 1985; and a conference volume titled Domestic Adjustment and International Trade, edited by Hufbauer and Rosen, to be published in 1986.

2. US International Trade Commission, Certain Motor Vehicles and Certain Chassis and Bodies Therefore, USITC Publication 1110, Washington, December 1980, p. A-9.

Reagan Administration to adopt the "voluntary" restraint agreement approach.

4. As a result, for over four years, the US auto industry has been protected from auto imports from Japan. Formal VRA protection existed from 1 April 1981 to 31 March 1985. Following a recommendation by the Cabinet Council on Commerce and Trade, President Reagan decided not to seek an extension of Japanese restraints beyond 1 April 1985.

5. Initially, the Japanese Ministry of International Trade and Industry (MITI) decided not to continue the "voluntary" restraints beyond March 1985 due to record 1984 earnings posted by the big U.S. automakers (over $10 billion), and a sharp reduction in unemployment in the U.S. auto industry. However, in large part due to Congressional resolutions, MITI officials announced that auto exports to the United States would be held to 2.3 million units in 1985, a 24 percent increase over the 1984 level. Thus, U.S. automotive imports continue to be restrained, although the restraint level is considerably higher and the mechanism is a unilateral Japanese voluntary export restraint (VER).

6. The reasons for the decline in competitiveness of US auto firms in the early 1980s are numerous. While exchange rates are most important, U.S. firms have also had to contend with labor cost disadvantages, and Japanese innovation in product design, production and marketing.

7. In response to the Japanese challenge, the domestic industry has modernized production facilities, adopting robotics on a large scale, and become more competitive in the small-car market. U.S. automakers have closed ten assembly plants, reorganized major divisions to increase efficiency, increased component outsourcing, lowered inventory carrying costs, and made significant gains in quality control. By increasing productivity while cutting both the salaried and hourly work force and renegotiating wages and work rules, the auto industry managed to reduce labor costs in the early 1980s. However, in September 1984, GM and the UAW signed a new three-year contract which raised wages and fringe benefits from about $22.80/hour to about $27.80/hour, and widened further the production cost disadvantage vis-a-vis Japan, from about $1,500 to a figure closer to $2,000 per car.

8. Meanwhile, Japanese automakers have committed $1.9 billion for new U.S. manufacturing ventures and investments in domestic auto companies. Honda constructed an auto assembly plant at Marysville, Ohio. Toyota agreed to a joint venture with GM to produce Toyota-designed cars in Fremont, California. Ford is planning a $500 million investment project in Mexico, where it will assemble a Toyo Kogyo subcompact. In June 1984, GM and the Dao Motor Company signed an agreement to produce 167,000 cars a year in South Korea by 1987.

9. Total U.S. auto imports fluctuated little from 1979 to

early 1983 due to the chilling effect of the VRA. However, in 1983-84, U.S. imports rose about 24 percent (to 3.6 million units) owing to increased demand for automobiles produced by US subsidiaries in Canada and for West German automobiles, and an increase in the level of the Japanese VRA from 1.68 to 1.85 million units.

10. The quota protection provided by the VRA induced an increase in the average new car selling price of Japanese automobiles of between 8 and 15 percent, due to scarcity rents and quality upgrading. This translated into an average VRA-induced price increase of about $700 to $1,000 per Japanese auto during the period 1981 to 1984. The reduced supply of autos and increased import prices allowed US automakers to increase their prices as well--an average of about 4.5 percent, or $400 per auto, during the restraint period. These figures spelled significantly higher consumer costs for automobiles. In 1983, the cost of trade restraints (VRA plus the tariff) to U.S. consumers was about $4.3 billion; by 1984, the cost has risen to about $6.0 billion. During the four-year period, the annual average cost to US consumers was about $3.9 billion.

11. There are several counterparts to higher costs paid by U.S. consumers: larger earnings realized by domestic producers; more tariffs collected by the U.S. Treasury; gains to Japanese holders of quotas; and sheer loss from a less efficient economy. In 1984, the gains to U.S. producers from Japanese restraints were about $2.7 billion; tariff revenues were about

$0.8 billion; the gain to Japanese exporters was about $2.9 billion; and the efficiency loss was about $0.2 billion.

12. Despite the Japanese restraints, U.S. employment levels declined dramatically between 1979 and 1982:

1979	929,214
1980	740,191
1981	723,946
1982	622,885
1983	656,970
1984	720,448

In 1982, 289,000 auto workers were placed on temporary or indefinite layoff. As a result of the 1984 sales recovery, employment rebounded by almost 100,000 persons by mid-1984; but the UAW was still 170,000 automotive jobs short of the 1978 level, a decline of 23 percent, with over 90,000 auto workers remaining on indefinite layoff.

13. My estimates indicate that the Japanese restraints "saved" about 45,000 automotive jobs in 1984. This occurred because trade restraints excluded about $4.1 billion of Japanese autos that would otherwise have entered the United States. The cost to U.S. consumers per job year "saved" in 1984 was about $133,000.

14. Correction of the hugely overvalued dollar will do much to reduce the problems of the U.S. auto industry. But extensive experience in other industries and other countries suggests that troubled industries are seldom rescued by currency realignments

alone.

15. Our case study on automobiles indicates that very substantial gains could be realized from policies that allowed greater imports of Japanese cars. The study also indicates that freer trade would put some people out of work. Much better programs need to be devised to deal with labor dislocation resulting from increased foreign competition. Otherwise a broad spectrum of American industry, including the auto industry, will continue to look at liberal trade policies with a jaundiced eye.

16. With some confidence, we can predict that auto sales, being highly cyclical. will turn down in the years ahead. When that happens, unemployment will surely rise, and pressures will mount to convert the relaxed VER regime back into a more confining VRA. However, the protracted use of quantitative restraints is very costly to the consumer, slows adjustment, and represents a very unfortunate trade policy. One alternative approach to the Japanese VRA/VER that we at the Institute have explored involves the following elements:

(a) The United States would auction quota permits to the highest bidder, rather than enter into a VRA with Japan or permit the Japanese government to enforce a VER. Recently, the International Trade Commission suggested the auctioned quota approach in the leather footwear case.

(b) The United States would then dedicate the quota auction revenue, (and existing tariff revenues, if needed) to the adjustment needs of the industry.

(c) As workers leave the industry, the United States would enlarge the level of quotas offered at auction.

17. This approach is intended to share the benefits of freer trade between American workers, firms, and consumers. My estimates suggest that a hypothetical adjustment program in 1986 would cost about $1.1 billion; by comparison, automobile quota auction and tariff revenues would be about $3.0 billion. Declining amounts would be spent on adjustment in subsequent years. Under this hypothetical program, industry employment would decline from 720,000 in 1984 to 576,000 in 1990, and imports would rise from 19 percent of the domestic market to about 26 percent. The level of protection (tariffs and quotas) would decline from about 11 percent in 1984 to about 5 percent in 1990.

18. The quota auction approach is designed to achieve several goals: collect quota rents which now accrue to Japanese auto exporters and deposit those rents in the U.S. Treasury; provide an earmarked fund for the adjustment needs of the industry; ensure that trade restraints are gradually liberalized so that the industry will once again compete in the world market place without protection. This is a radically different approach than the United States has followed in some 30 cases of special protection since the Smoot-Hawley Tarriff of 1930. But with protection on the upswing, and the world trading system under severe attack, this is a very good time to think about new approaches.

Institute for International Economics
Trade Adjustment Project
1 June 1985

Case

Automobiles

Period of relief

1 April 1981 to 31 March 1985, with continuing Japanese export restraints to the present

Supplier affected

Japan

Relief action

On 12 June 1980, the United Auto Workers (UAW) filed a petition with the US International Trade Commission (ITC) under Section 201 of the Trade Act of 1974. The petition claimed that the domestic industry producing on-the-highway passenger automobiles, automobile trucks, and bodies (including cabs) and chassis for automobile trucks (provided for in items 692.02, 692.03, 692.10, 692.11, 692.20, and 692.21 of the Tariff Schedules of the United States) was being seriously injured by foreign imports. On 30 June 1980, the ITC instituted an escape clause investigation, and on 4 August 1980, the Ford Motor Company joined the investigation as a co-petitioner for import relief. (USITC 1110, A78, A85; USITC Annual Report 1980).

On 10 July 1980, the ITC received a letter from President Jimmy Carter requesting that the Commission accelerate its investigation in view of the large number of businesses, workers, and consumers for whom an investigation taking the full six months "could cause major uncertainties." Similar requests were filed by a substantial number of senators and congressmen, by the UAW, and by others. After

considering these requests, including statements filed by persons opposing acceleration, the ITC decided to accelerate its investigation by approximately three weeks. (USITC 1110, A1).

On 10 November 1980, the ITC determined by a 3-2 vote that on-the-highway passenger automobiles and light trucks were not being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or threat of serious injury, to the domestic industry. The majority of Commissioners found the decline in demand for new automobiles and light trucks owing to the general recessionary conditions in the US economy to be a far greater cause of injury to the domestic industry than increased imports. They also found that the structural shift in the automotive market which increased the proportion of small, fuel-efficient vehicles demanded in relation to total vehicles demanded was an important cause of injury, but not in and of itself a greater cause than the relative import increase. (USITC 1110, 34-35; USITC 1648, 1).

Following the ITC decision, the auto industry appealed to the Carter Administration for trade restrictions against auto imports. The Administration resisted the pressure and instead authorized massive Trade Adjustment Assistance (TAA) benefits. By early 1981, legislation to restrict Japanese auto imports was gaining broad support in Congress. On 5 February 1981, Senators John C. Danforth (R-Mo.) and Lloyd Bentsen (D-Tex.) introduced legislation (S 396) to limit automobile exports from Japan to 1.6 million units per year for 1981, 1982, and 1983. (Nanto, 14).

In April 1981, following meetings with US trade officials, the Japanese Ministry of International Trade and Industry (MITI) presented a proposal for voluntarily restraining auto exports to the United States to allow the US industry time to make the necessary adjustments to become more competitive with imports. Japan proposed to limit its auto exports to 1.6 to 1.7 million units annually to be enforced by MITI through administrative guidance. Japanese automakers were critical of the plan, stating that high demand for small cars and high US wages were responsible for the US auto industry slump. To complicate matters, the European Community contended that any restraint agreement with the United States should also limit Japanese shipments to the EC. (USITC 1648, 1-2; Feenstra, 5).

On 2 May 1981, MITI announced it had reached a voluntary restraint agreement (VRA) with the administration of President Ronald Reagan. The VRA reduced Japanese auto exports to the United States by 7.7 percent, from the 1980 level of 1.82 million units to 1.68 million units for the period 1 April 1981 through 31 March 1982. MITI indicated that a decision on a second year of restraints would be made after observing the 1981 market performance of the US industry. At a later date the Japanese announced that exports to the United States of four-wheel-drive station wagons and "jeep"-type vehicles would be limited to 82,500 units, and exports to Puerto Rico would not exceed 70,000 units. Thus, total Japanese exports of autos and "utility" vehicles to the United States for 1981 were set at 1,832,500 units. (USITC 1648, 2; Tarr and Morkre, III-2).

In early February 1982, "domestic content" legislation was introduced in Congress (HR 5133) which would have required that a very high percentage of the value of motor vehicles sold in the United States -- over 70 percent in the case of imports by major Japanese suppliers -- consist of domestic parts and materials. On 29 March 1982, partly as a response to protectionist pressures on Capitol Hill, Japan renewed the VRA for the period April 1982 to March 1983 at the 1.68 million unit ceiling, plus allowances for "utility" vehicles and exports to Puerto Rico. Despite a second year of voluntary restraints, HR 5133 passed the House on 15 December 1982 by a vote of 215 to 188; however Congress adjourned before the Senate version of the bill (S 2300) came to the floor. (Feenstra, 4-6; Nanto, 1).

On 3 February 1983, Congressman Richard L. Ottinger (D-NY) again introduced domestic content legislation, essentially identical to HR 5133, entitled the "Fair Practices in Automotive Products Act" (HR 1234). On 12 February 1983, again in response to Congressional pressure, Japan renewed the VRA for a third year (April 1983 through March 1984) at the current ceiling levels. On 3 November 1983, by a vote of 219-199, the House of Representatives passed HR 1234. The Senate bill (S 707) was referred to the Senate Commerce Committee but no action was taken prior to adjournment.

On 1 November 1983, the Japanese Government announced that it would increase its voluntary export limit from 1.68 million to 1.85 million automobiles during the period 1 April 1984 to 31 March 1985. In addition, it announced that the four-wheel-drive and "jeep"-type

vehicle limit would be increased to 90,848 units and exports to Puerto Rico would rise to 77,083 units. The total number of Japanese automobiles (excluding automobile trucks) exported to the United States during 1984 was to increase from 1,832,500 to 2,017,931 units, a 10.1 percent increase over the previous three-year level. (USITC 1648, 2; Nanto, 1).

In October 1984, Ford, Chrysler, American Motors, and the UAW urged the Reagan Administration to extend the Japanese voluntary export restraints for a fifth year, from 1 April 1985 to 31 March 1986. At the same time, General Motors and the American International Automobile Dealers Association came out against a continuation of the restraints. (Washington Post, 23 October 1984, D1).

On 30 January 1985, high-level officials of MITI disclosed that Japan's "voluntary" ceiling on automobile exports, scheduled to expire on 31 March 1985, would not be renewed. MITI indicated that the decision not to renew the restraints was based on the record 1984 earnings posted by the big US automakers plus the sharp reduction in unemployment in the US auto industry. Ministry officials stressed, however, that elimination of the four-year-old quota system would be accompanied by some new form of restriction (i.e., traditional "administrative guidance" procedures) in order to prevent a sudden climb in auto shipments to the American market. (Journal of Commerce, 31 January 1985, 1A).

On 19 February 1985, the Cabinet Council on Commerce and Trade recommended to President Reagan that he let Japan decide whether or not to continue its voluntary quotas on automobile exports for a fifth year. This recommendation came as key congressmen, organized labor and three of the four US automakers pressed the White House to continue the restraints in light of the record US trade deficit with Japan. (New York Times, 20 February 1985, D1; Washington Post, 20 February 1985, A1).

In March 1985, President Reagan decided not to ask Japan to continue its voluntary auto restraints after the limit expired on 1 April 1985. Following this decision, and in part due to the introduction of a number of resolutions in Congress calling for continued automobile restraints, Japan announced that it would hold auto exports to the US to 2.3 million units in 1985, up 25 percent from fiscal 1984. (Journal of Commerce, 14 May 1985, 5A; New York Times, 20 February 1985, D1).

Changes in the industry

Since 1979, offshore automakers have committed $1.9 billion for new US manufacturing ventures and investments in domestic auto companies. Honda constructed an auto assembly plant at Marysville, Ohio. Toyota agreed to a joint venture with GM to produce Toyota-designed cars in Fremont, California. Ford is planning a $500 million investment project in Mexico, where it will assemble a Toyo Kogyo subcompact. In June 1984, General Motors and the Dao Motor Company signed a $426 million agreement to produce 167,000 cars a year in South Korea by 1987. (Simison, 1; Temple, 8; Reich; New York Times, 9 July 1984, D1).

The domestic industry has modernized production facilities, adopting robotics on a large scale, and become more competitive in the small-car market.[1] US automakers have closed ten assembly plants, reorganized major divisions to increase efficiency, increased component outsourcing, lowered inventory carrying costs, and made significant gains in quality control. By increasing productivity while cutting both the salaried and hourly work force and renegotiating wages and work rules, the auto industry managed to reduce labor costs in the early 1980s. However, in September 1984, GM and the UAW signed a new three-year contract which raised wages and fringe benefits from about $22.80/hour to about $27.80/hour, and widened further the production cost disadvantage vis-a-vis Japan --

---

1. In January 1985, General Motors announced plans for a totally new small car to be built by a separate, wholly-owned subsidiary called the Saturn Corporation. According to company representatives, this new car is aimed at making GM "cost competitive with the lowest-priced imports." (Journal of Commerce, 9 January 1985, 1A; New York Times, 9 January 1985; D1).

from about $1,500 to about $2,000 per car. (Wharton, 4-5; USITC 1648, vi; Samuelson, 49).

Employment by the six domestic auto producers dropped each year during 1979 to 1982. In 1982, 289,000 auto workers were placed on temporary or indefinite layoff. Although employment rebounded by almost 100,000 by mid-1984 as a result of the 1984 sales recovery, the UAW was still 170,000 automotive jobs short of the 1978 level, a decline of 23 percent, with over 90,000 auto workers on indefinite layoff. Some experts estimated that by 1982 productivity increases had resulted in a permanent reduction of over 150,000 jobs (compared to the 1978-79 peak of almost one million workers). (USITC 1648, vi; Temple, i; Wall Street Journal, 31 May 1984, 14; Wharton, 17).

Despite some $50 billion in investment, the domestic industry is relying increasingly on Japan for subcompact technology. Auto production for the US market is now viewed as a "mature" industry with long-term growth limited to the rate of growth of real income.[2] Nevertheless, in 1984, the US auto industry had its best profit year since 1977. In Forbes listing of the largest 500 US companies according to profit, GM ranked third, Ford Motor Company ranked fourth, and Chrysler ranked ninth. These rankings jumped from their 1983 levels of fourth, sixth and forty-fourth, respectively. (Wharton, 4-5; Samuelson; Fisher, 20; Altshuler, 110; Forbes, 174).

---

2. Average annual car mileage has declined 12 percent since 1978 to 8,037 miles, and new-car buyers are keeping their cars an average of 5.1 years, more than one year longer than in 1978. In addition, higher gasoline prices have crimped US demand for automobile services. After the rapid increase in the price of gasoline during 1979-80, consumers changed their purchases of mostly large autos to that of smaller, more fuel-efficient models. As the price of gasoline leveled and the general economy improved in late 1982, many consumers switched from smaller domestic models to larger models. (USITC 1648, v; Wall Street Journal, 3 May 1984, 1).

Key Statistics

Imports from Japan

Volume of imports (million units)

Prior to the VRA	1979	(USITC 1419, 4)	1.62
	1980	(USITC 1419, 4)	1.99
During the VRA	1981	(USITC 1419, 4)	1.91
	1982	(USITC 1419, 4)	1.80
	1983	(USITC 1648, 42)	1.87
	1984	(USITC 1648, 42)	1.97

Value of imports (billion dollars)

Prior to the VRA	1979	(USITC 1419, 4)	$ 6.47
	1980	(USITC 1419, 4)	$ 8.23
During the VRA	1981	(USITC 1419, 4)	$ 9.49
	1982	(USITC 1419, 4)	$ 9.61
	1983	(USITC 1585, 4)	$10.76
	1984	(USITC 1648, 42)	$12.50

Imports from all sources[3]

Volume of imports (million units)

Prior to the VRA	1979	(USITC 1419, 4)	3.01
	1980	(USITC 1419, 4)	3.11
During the VRA	1981	(USITC 1419, 4)	2.86
	1982	(USITC 1419, 4)	2.93
	1983	(USITC 1650, 2)	3.69
	1984	(USITC 1650, 2)	3.56

Value of imports (billion dollars)

Prior to the VRA	1979	(USITC 1419, 4)	$14.85
	1980	(USITC 1419, 4)	$16.68
During the VRA	1981	(USITC 1419, 4)	$17.69
	1982	(USITC 1419, 4)	$20.18
	1983	(USITC 1650, 2)	$24.17
	1984	(USITC 1650, 2)	$29.26

---

3. US imports fluctuated little from 1979 to early 1983 due in large part to the VRA, which held Japanese imports constant during the latter part of this period. However, in 1983-84, US imports rose to 3.6 million units owing to increased demand for automobiles produced by US subsidiaries in Canada and West German automobiles, and an increase in the level of the Japanese VRA from 1.68 million units to 1.85 million units. (USITC 1648, vii).

Apparent consumption

Volume of consumption (million units)

Prior to the VRA	1979	(USITC 1419, 2)	10.64
	1980	(USITC 1648, 36)	8.97
During the VRA	1981	(USITC 1648, 36)	8.53
	1982	(USITC 1648, 36)	7.98
	1983	(USITC 1648, 36)	9.18
	1984	(USITC 1648, 36)	10.40

Value of consumption (billion dollars)[4]

Prior to the VRA	1979	(own estimate)	$60.37
	1980	(own estimate)	$53.31
During the VRA	1981	(own estimate)	$58.46
	1982	(own estimate)	$58.60
	1983	(own estimate)	$66.33
	1984	(own estimate)	$83.57

Market share of imports (percentage of apparent consumption, by volume)

From Japan

Prior to the VRA	1979	(own estimate)	15.2%
	1980	(own estimate)	22.2%
During the VRA	1981	(own estimate)	22.4%
	1982	(own estimate)	22.6%
	1983	(own estimate)	20.4%
	1984	(own estimate)	18.9%

From all sources

Prior to the VRA	1979	(own estimate)	28.3%
	1980	(own estimate)	34.7%
During the VRA	1981	(own estimate)	33.5%
	1982	(own estimate)	36.7%
	1983	(own estimate)	40.2%
	1984	(own estimate)	34.2%

---

4. These figures are derived from the value of imports from all sources and domestic output, with minor adjustments reflecting the volume of exports.

Output of domestic industry (US shipments)

Volume of output (million units)

Prior to the VRA	1979	(USITC 1419, 2)	8.42
	1980	(USITC 1648, 36)	5.58
During the VRA	1981	(USITC 1648, 36)	6.20
	1982	(USITC 1648, 36)	5.76
	1983	(USITC 1648, 36)	6.80
	1984	(USITC 1648, 36)	7.96

Value of output (billion dollars)

Prior to the VRA	1979	(USITC 1110, A49; own estimate)	$50.19
	1980	(USITC 1110, A49; own estimate)	$41.13
During the VRA	1981	(USTR-1983, 98; own estimate)	$44.58
	1982	(USTR-1983, 98; own estimate)	$43.82
	1983	(USITC 1650, 4; own estimate)	$52.22
	1984	(USITC 1650, 4; own estimate)	$63.20

Employment in domestic industry[5]

Prior to the VRA	1979	(USITC 1648, 9)	929,214
	1980	(USITC 1648, 9)	740,191
During the VRA	1981	(USITC 1648, 9)	723,946
	1982	(USITC 1648, 9)	622,885
	1983	(USITC 1648, 9)	656,970
	1984	(USITC 1648, 9)	720,448

---

5. These figures reflect the average number of production and nonproduction employees in US auto-producing firms. The figure for 1984 reflects employment during the period January to June.

Wages and benefits per hour[6]

Prior to the VRA	1979	(Crandall, 11)	$13.68
	1980	(Crandall, 11)	$16.29
During the VRA	1981	(Crandall, 11)	$17.28
	1982	(Crandall, 11)	$18.66
	1983	(Crandall, 11)	$19.02
	1984	(Samuelson)	$22.80

Industry profits[7] (billion dollars, net operating profit (loss) before taxes)

Prior to the VRA	1979	(USITC 1648, 13)	$(0.4)
	1980	(USITC 1648, 13)	$(4.7)
During the VRA	1981	(USITC 1648, 13)	$(2.3)
	1982	(USITC 1648, 13)	$(0.6)
	1983	(USITC 1648, 13)	$ 5.3
	1984	(USITC 1648, 13)	$10.4

Industry capacity utilization[8]

Prior to the VRA	1979	(USITC 1648, 18)	82.9%
	1980	(USITC 1648, 18)	65.0%
During the VRA	1981	(USITC 1648, 18)	67.8%
	1982	(USITC 1648, 18)	54.6%
	1983	(USITC 1648, 18)	69.6%
	1984	(USITC 1648, 18)	86.8%

---

6. The UAW "gave back" about $2 billion in wages and benefits in the contract expiring fall 1984, compared with the prior contract. Japanese firms are estimated to have an $8-to-$10-an-hour advantage in labor costs. (Fisher, 21; Wall Street Journal, 14 May 1984, 1).

7. The 1984 figure reflects an annualized estimate of profits reported by the six US producers of autos during January to June 1984. During the period of the VRA, the four domestic auto companies (General Motors, Ford, Chrysler, and American Motors) registered total net profits of almost $13.0 billion on their US operations. (USITC 1648, vii).

8. Capacity for the US production of autos decreased from 10.1 million units in 1979 to 8.6 million in 1983 before rising to 9.0 million in 1984. (USITC 1648, v).

Quantitative profile

Item	Source	Amount
Number of years restraints in force (imposed by US, 1981-1985)		4 years, with continuing Japanese restraints thereafter
Induced increase in price of imported autos	(USITC 1648, 36)[9] (Feenstra, 10)[10] (Tarr & Morkre, III-17)[11] (Crandall, 16) (own estimate)[12]	7.9 percent (1981-84 average) 8.4 percent 9.6 percent (1981) 15.3 percent ($1,000 per auto) 11 percent (1981-84 average)
Induced increase in price of domestic autos	(Crandall, 16) (own estimate)[13]	5.0 percent (1981-83) or $400 per auto 4.4 percent (1981-84 average)
Coefficient of price response	(own estimate)	0.4
Quantity and value of imports (1984)	(USITC 1650, 2) (USITC 1650, 2)	3.56 million units $29.3 billion
Induced decrease in imports due to restraints	(Harbridge, 1) (USITC 1648, 42) (own estimate)	7 percent 0.5 million units (about 25 percent) $4.1 billion

---

9. According to ITC estimates, transaction prices of Japanese automobiles sold in the United States in 1984 averaged $1,300 more per auto as a result of the VRA than they would otherwise have been. The estimated VRA-induced price increase of Japanese autos in the US rose from $185 per auto in 1981 to $359 in 1982, and to $831 more per auto by 1983. This reflects an average VRA-induced price increase of $670 per Japanese auto during the period 1981-84. (USITC 1648, viii).

10. This figure reflects a scarcity rent import price increase of 2.4 percent and a price increase due to quality upgrading of 6.0 percent. (Feenstra, 26).

11. According to Tarr and Morkre, the unit value of Japanese automobiles rose 20 percent in 1981. Of this increase, 1.7 percent resulted from an increase in the cost of inputs; 2.7 percent resulted from exchange rate changes; 6 percent resulted from additional costs required to produce higher-quality vehicles, and 9.6 percent resulted from the VRA. (Tarr and Morkre, III 17-19).

12. This estimate includes the effect of the regular ad valorem tariff of 2.7 percent, plus an average 8 percent increase due to the VRA.

13. According to Wharton Econometrics, the average new car selling price has increased nearly $2,600 (35 percent) since April 1981. In common with other observers, we attribute only a small part of this increase to the VRA. (Wharton, 8).

Item	Source	Amount
Quantity and value of domestic production (1984)	(USITC 1648, 36) (USITC 1650, 4; own estimate)	7.96 million units $63.2 billion
Induced increase in domestic production due to restraints	(USITC 1648, ix) (own estimate)	8 percent 0.5 million units
Coefficient of quantity response	(own estimate)	1.0
Elasticity of demand for imported autos (Japan basic car)	(CEA, A2) (Feenstra, 29)	3.5 2 to 3
Elasticity of supply of domestic autos	(own estimate)	0.3
Elasticity of demand for domestic autos	(Wharton, 26) (Wharton, 26) (USITC 1110, A59) (own estimate)	1.0 to 1.5 2 to 3 (small cars) 1.0 1.5
Cross-elasticity of demand for US basic car relative to price of Japan basic car	(CEA, A2) (own estimate)	0.78 0.72
Cross-elasticity of output of domestic autos relative to price of imported autos	(own estimate)	0.12
Cross-elasticity of quantity of imported autos relative to price of domestic autos	(own estimate)	0.67
Cost of restraints to US consumers	(Tarr & Morkre, III-4)[14] (Crandall, 16) (own estimate)	$3.9 billion (1981-84 average) $4.3 billion (1983) $6.0 billion (1984)
Gain from restraints to US producers	(Tarr & Morkre, III-4) (own estimate)	$418 million (1983) $2.7 billion (1984)
Tariff revenue and implied average tariff rate (1984)	(own estimate) (Tarr & Morkre, III-22)	$790 million 2.7 percent

---

14. According to ITC staff estimates, the VRA cost US consumers an additional $835 million in 1981, $1.65 billion in 1982, $4.68 billion in 1983, and $8.52 billion in 1984, for a combined total of $15.7 billion during 1981-84. (USITC 1648, ix).

Item	Source	Amount
Gain from restraints to importers	(Tarr & Morkre, III-4) (own estimate)	$3.0 billion (1983) $2.9 billion (1984)
Efficiency loss from larger domestic production to the US (1984)	(own estimate)	$170 million
Welfare cost of restraints to the US	(Crandall, 13) (Tarr & Morkre, III-4) (own estimate)	$2 billion (1981-83 average $908 million (1983) $3.1 billion (1984)
Employment in protected US industry	(USITC 1648, 9) (USITC 1648, 9)[15]	723,946 (1981) 720,448 (1984)
Induced increase in employment	(Tarr & Morkre, III-27) (Feanstra, 29)[16] (Crandall, 16) (USITC 1648, 4) (own estimate)[17]	4,600 5,600 to 11,100 26,200 44,100 45,000
Cost of restraints to US consumers per job saved	(Tarr & Morkre, III-14) (Crandall, 16) (own estimate)	$241,235 (1983) $160,000 (1983) $133,000 (1984)
Gain from restraints to US producers per job (1984)	(own estimate)	$4,000

---

15. This figure reflects employment in the US industry during the period January to June 1984.

16. This figure reflects an import demand elasticity of 2 to 3.

17. Our estimate is based on the ratio between the induced increase in domestic production (0.5 million units) and the 1984 level of domestic production (7.96 million units), times the 1984 level of employment (720,448).

Hypothetical Adjustment Program (dollar figures at 1984 prices)[18]

	1984	1985	1986	1987	1988	1989	1990
US purchases of automobiles (million units)							
Assumed consumption growth of 2%	10.40	10.61	10.82	11.04	11.26	11.48	11.71
Imports from all sources (million units)							
Assumed consumption growth of 2% and no change in import restraints	2.00	2.04	2.08	2.12	2.16	2.21	2.25
Assumed consumption growth of 2% and degressive tariff (price elasticity of 3.5)	2.00	2.14	2.29	2.45	2.62	2.81	3.00
Import share of consumption with degressive tariff	19.2%	20.2%	21.2%	22.2%	23.3%	24.5%	25.6%
Hypothetical quota auction and existing tariffs							
Tariff equivalent of existing tariff and quota auction (degressive at one percentage point per year)	Tariff equivalent of 11%	10%	9%	8%	7%	6%	5%
Quota auction and existing tariff revenue (billion $)	——	$3.1	$3.0	$2.9	$2.7	$2.5	$2.2

---

18. This program assumes that Japanese export restraints are replaced by a quota auction administered by the United States.

	1984	1985	1986	1987	1988	1989	1990
US production for domestic markets (million units)[19]							
Assumed consumption growth of 2% and constant import share	8.40	8.57	8.74	8.92	9.10	9.27	9.46
Assumed consumption growth of 2% and rising import share	8.40	8.47	8.53	8.59	8.64	8.67	8.71
US employment in automobile industry (thousand workers)[20]							
Assumed 5% annual productivity growth and constant import share	—	720	700	679	659	640	622
Assumed 5% annual productivity growth change and rising import share	—	720	700	667	635	605	576
Year-to-year employment changes (thousand workers)							
Changes induced by consumption growth and productivity growth with constant import share	—	—	-20	-21	-20	-19	-18
Changes induced by rising import share	—	—	—	-12	-12	-11	-11
Total employment changes	—	—	-20	-33	-32	-30	-29

---

19. The figures are calculated as US purchases less imports.

20. Employment figures include workers engaged in production for export.

	1984	1985	1986	1987	1988	1989	1990
Assumed separations by quits, retirements, etc., not requiring adjustment assistance (1% of labor force)[21]	—	—	8	8	8	7	7
Separations requiring adjustment assistance	—	—	16	32	30	29	28
Benefit and budget calculations							
Annual wage cost per worker assuming constant $22.00 per hour/1600 hours	—	$35,000	$35,000	$35,000	$35,000	$35,000	$35,000
Benefits calculated at two times annual wage cost per worker (billion $)	—	—	$1.1	$2.2	$2.1	$2.0	$2.0
Projected program surplus or deficit: tariff revenue less benefits (billion $)	—	$3.1	$1.9	$0.7	$0.4	$0.5	$0.2

---

21. The one percent figure is based on the proportion of the labor force in each year age-group 55 to 64 years old.

Bibliography

Altshuler, Alan, et alia. 1984. The Future of the Automobile: The Report of MIT's International Automobile Program. Cambridge, Massachusetts: MIT Press.

Auerbach, Stuart and David Hoffman. 20 February 1985. "Car Quotas to be Left Up to Japan." Washington Post, p. A1.

Balassa, Carol. 1984. "Levels of Protection on Manufactured Goods: The US, EC, Canada, Japan." Unpublished manuscript. Washington: Office of the US Trade Representative.

Boyd, Gerald M. 20 February 1985. "US Aides Ask for End to Car Quotas." New York Times, p. D1.

Cohen, Robert B. 1983. "The Prospects for Trade and Protectionism in the Auto Industry." In Trade Policy in the 1980s, William R. Cline, ed. Washington: Institute for International Economics.

Council of Economic Advisers. 24 May 1982. "Domestic Content Requirements for US Auto Sales: An Economic Assessment." Washington: Executive Office of the President.

Crandall, Robert W. 27 June 1984. "Import Quotas and the Automobile Industry: The Costs of Protectionism." Statement before the Committee on Foreign Relations of the United States Senate. 98th Cong., 2nd sess. Washington. Reproduced in The Brookings Review, Summer 1984. (Page citations are to the Review.)

Cullison, A.E. 31 January 1985. "Japan Won't Renew US Car Export Ceiling." Journal of Commerce, p. A1.

Feenstra, Robert C. January 1984. "Voluntary Export Restraint in US Autos, 1980-81: Quality, Employment, and Welfare Effects." In The Structure and Evolution of Recent U.S. Trade Policy, Robert Baldwin and Anne Krueger, editors. National Bureau of Economic Research. Chicago: University of Chicago Press. (Page references are to typescript manuscript).

Fisher, Anne B. June 1984. "Can Detroit Live Without Quotas?" 109 Fortune 13: 20-25.

Forbes, Inc. 29 April 1985. "The Forbes Profits 500." Forbes, p. 174.

Harbridge House. July 1982. Domestic Content Legislation, A Tax on the American Auto Consumer. Study prepared for the American International Automobile Dealers Association. Washington.

Holusha, John. 30 September 1984. "A Race for Greater Auto Profits." New York Times, Section 3, p. 1.

Morici, Peter and Laura L. Megna. 1983. US Economic Policies Affecting Industrial Trade: A Quantitative Assessment. Report No. 200. Washington: National Planning Association, Committee on Changing International Realities.

Nanto, Dick K. 7 December 1983. Automobiles Imported from Japan, Issue Brief No. IB80030. Washington: Library of Congress, Congressional Research Service, Major Issues System.

Reich, Robert B. 13 May 1984. "Quotas Allow Auto Makers Not to Invest in Future." Los Angeles Times, Part IV, p. 3.

Samuelson, Robert J. 8 October 1984. "Pampering the Auto Industry." Newsweek, p. 49.

Simison, Robert L. 3 May 1984. "Despite Strong Sales, Auto Makers Believe Real Booms Are Over." Wall Street Journal, p. 1.

Tarr, David G. and Morris E. Morkre. December 1984. "Aggregate Costs to the United States of Tariffs and Quotas on Imports: General Tariff Cuts and Removal of Quotas on Automobiles, Steel, Sugar, and Textiles." Bureau of Economics Staff Report. Washington: Federal Trade Commission.

Temple, Barker & Sloane. January 1984. The Imported Automobile Industry in America. Study prepared for the American International Automobile Dealers Association. Massachusetts.

US International Trade Commission. February 1985. The U.S. Automobile Industry: Monthly Report of Selected Economic Indicators. USITC Pub. 1650. Washington.

_____. February 1985. A Review of Recent Developments in the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements. USITC Pub. 1648. Washington.

_____. August 1984. The US Automobile Industry: Monthly Report on Selected Economic Indicators. USITC Pub. 1564. Washington.

_____. July 1984. The US Automobile Industry: Monthly Report on Selected Economic Indicators. USITC Pub. 1551. Washington.

_____. June 1984. The US Automobile Industry: Monthly Report on Selected Economic Indicators. USITC Pub. 1541. Washington.

_____. May 1984. The US Automobile Industry: Monthly Report on Selected Economic Indicators. USITC Pub. 1527. Washington.

_____. August 1983. The US Auto Industry: US Factory Sales, Retail Sales, Imports, Exports, Apparent Consumption, Suggested Retail Prices, and Trade Balances with Selected Countries for Motor Vehicles, 1964-82. USITC Pub. 1419. Washington.

_____. August 1981. Automotive Trade Statistics 1964-1980. USITC Pub. 1171. Washington.

_____. Annual Report 1980. USITC Pub. 1084. Washington.

_____. December 1980. Certain Motor Vehicles and Certain Chassis and Bodies Therefor. USITC Pub. 1110. Washington.

US Trade Representative. April 1984. Annual Report of the President of the United States on the Trade Agreements Program 1983. Washington: Executive Office of the President.

_____. November 1982. Twenty-Sixth Annual Report of the President of the United States on the Trade Agreements Program 1981-82. Washington: Executive Office of the President.

_____. 1982. Twenty-Fifth Annual Report of the President of the United States on the Trade Agreements Program 1980-1981. Washington: Executive Office of the President.

Wayne, Leslie. 8 April 1984. "The Irony and Impact of Auto Quotas." New York Times, p. F1.

Wharton Econometric Forecasting Associates. July 1983. Impact of Local Content Legislation on US and World Economies, "The Fair Practices in Automotive Products Act," H.R. 1234. (Abridged and unabridged) Study prepared for the Japan Automobile Manufacturers Association. Philadelphia.

Representative LUNGREN. Thank you very much, Mr. Hufbauer. Mr. Angel, please proceed.

STATEMENT OF ROBERT C. ANGEL, PRESIDENT, ANGEL ASSOCIATES, INC.

Mr. ANGEL. Thank you, Congressman Lungren. Just a summary of my prepared statement. I was asked to talk about the impact of the VER on Japan's auto industry, and then on Japan's Government, since I'm a political analyst and not an economist. And finally, a comment on the advisability of using the VER to deal with future sectoral disputes with Japan.

The impact on industry has been pretty well covered. The Japanese were able to make a little more money with a little less iron, and while the little producers weren't as happy as the big producers—the big producers got the lion's share of the frozen market share allocation—they made out all right too.

So the industry wasn't thrilled, but it wasn't damaged.

Now the impact on Japan's Government is a little more complicated, and impossible to quantify. But I would argue that it's been far more favorable than that on the industry.

This VER allowed the Government to strengthen its influence over Japan's auto industry, something Japan's bureaucrats certainly welcomed, even though they might not want to admit it in public.

In my prepared statement, I provided you with a little background on Japan's Government-business relationship, warning that the Japan incorporated model, especially in its more bizarre political presentation form, can be quite misleading. But I adding that Japan's bureaucrats, tend to be quite a bit more pedagogical than our own and even Europe's vis-a-vis industry.

Japan's bureaucrats somehow consider themselves to be the ultimate definers and defenders of Japan's national interest. And somehow they get away with that. It's not their politicians; it's their bureaucrats that are believed to take care of the people in Japan.

I gave one example in the prepared statement of the "amakudari" system, which is part of their Government retirement system, where young, senior Government officials retire from Government and then, at the age of 52 or 53, have to take another job in industry. This provides an example of why it is important for Japan's bureaucracy to be able to have some hold over their industry. Japanese companies aren't going to take these people and pay them at the salaries that they have to pay them, if they don't believe they're going to get something out of it.

And of course, the more dependent the industry is on Government, the more they hope to get out of it.

Japanese industry, as a whole, is becoming more independent of the Government as their capital resources and their international experience expands. They're getting a little harder to handle, a little more independent, and this is a problem for government for a variety of reasons. On the altruistic side, the bureaucrats think they're the ones that know what's best for Japan, and on the more personalistic level, they have to go to these companies and get jobs afterward.

So in conclusion, the VER didn't hurt Japan's auto industry very much, and it did a nice favor for Japan's economic bureaucrats. Maybe that's why, in the late 1970's and early 1980's, there were so many of those people in this town privately, unofficially urging our Government to bash away at them, in order to encourage this agreement.

Now the final question was, should the U.S. Government promote VER's as a solution to future bilateral—U.S.-Japanese—sectoral problems? I don't think it should. I agree with most of what's been said before.

I would add, that when the U.S. Government intervenes, such intervention should be done directly and not indirectly.

The most important reason is that when we do it indirectly, we put the advantage of initiative on the Japanese side. When we go about achieving a voluntary restraint agreement, how do we do it? We have to sit here in Washington—the Congress and the executive branch—and fuss, until the Japanese become persuaded that we are really serious, and are about to do something to them, if they don't come across with a voluntary agreement.

That is an embarrassing position to be in, in my opinion. We're totally dependent upon the people that advise the Japanese, the Washington "temperature takers," I call them, that the Japanese rely on for their advice. Now, you know how that is. I'm sure you get it yourself. Somebody from Japan will come visit you. The first

question they ask, "How is the relationship? Are you people really upset?" And then on our side, we're obliged to storm up and down and pound our head on the wall and say, you know, "This is the end. You're really going to get it, if you don't do something. You better get the message." We call this the point where the Japanese get the message. That's unbecoming, and we should stop it. If we want Japan to do something, it should be our own action that controls the situation to the extent possible.

We shouldn't have to rely on them and their perception of the redness of our face.

The advantage of the VER-type arrangement, as you call it, is that the United States doesn't get blamed for a blatant protectionist act.

Well, I don't know how important that is. That seems to be important to the "Trade Pharisees," the legal people that handle these things. But we're not kidding anyone. The reason that we don't get kicked in the teeth for it isn't our diplomatic skill. It's because we've got a bigger gun and our economy's bigger, and other countries don't dare to hit us.

It would be the same thing if we implemented something directly, if we had to. I'm not saying we should or that we shouldn't, when we have to.

I don't see the difference. The pressures come. They might be domestic rather than international, but they still come.

Its most important advantage though is its infinite flexibility. The VER solution can be implemented without any specific foreign economic policy or clear definition of objectives in mind. As a result, the VER allows one to get away with murder. It has, as the stick by which it's measured a political not an economic objective: "Was it a success or not?" "Well, it took the pressure off. The Congress didn't come out wild eyed after everbody and go and shut down the international trading system. So I guess it was a success."

That's a political judgment, not an economic judgment. And so to that extent, the VER has a certain advantage. In consequence, we don't really have to put together a genuine foreign economic policy, involving a set of clearly defined foreign economic objectives and the means to achieve them in order to put this thing through.

One final advantage, I might add, for this VER type of solution is that it creates a tremendous demand in Tokyo for the services of the "Washington temperature takers." And perhaps that shouldn't be taken too lightly. I think probably it does a great deal for our current account balance of trade with Japan. Because of this VER approach we take, the Japanese have to hire all kinds of lobbyists and public relations operatives to tell them the exact moment when Washington is going to explode.

And just before that, they do something. That's a very valuable service.

Representative LUNGREN. It's usually before congressional work periods.

Mr. ANGEL. That's right. And often the people who take these jobs, of course, are people who leave the executive and legislative branches of Government, so maybe the Japanese amakudari system has extended even to Washington in that regard.

In conclusion, when, we have to do something, do it directly, with direct action. Stop threatening the Japanese. The Japanese are sick of hearing it. Each time we threaten, our threat has to be more extreme in order to be effective. Take action, based upon a predetermined economic objective.

[The prepared statement of Mr. Angel follows:]

Prepared Statement of Robert C. Angel

PREFACE

I have been asked to address two general questions: First, what impact has the voluntary automobile export restraint arrangement had on Japan's government and on that nation's major automotive exporters; and second, during future negotiations with Japan, should the United States be encouraged to press for similar VERs covering other sectors?

EFFECT ON JAPAN'S AUTO INDUSTRY:

I have only limited knowledge of the corporate side of Japan's auto industry, but available evidence suggests that the major manufacturers fared quite well, compensating for reduced sales opportunities with shipments of higher-priced, accessory-laden vehicles with their larger profits during the period of

government-supervised restraint of shipments to the American market.[1] Japan's smaller, more recently established auto manufacturers were placed in a less enviable position, their plans for rapid export sales expansion stymied by the relatively small quotas they were forced to accept on the basis of their past sales performance. These smaller manufacturers were less satisfied from the beginning with the export restraint arrangement, having anticipated considerably more success in a restraint-free U.S. market.

With continued strong U.S. demand for their products, Japan's auto manufacturers would have enjoyed better sales volume and made even more money in the absence of restraints, at least in the short-term. But any resulting sense of frustration such calculations might inspire should be calmed by the very real possibility that without a restraint agreement the American political system at some point would have imposed even more damaging political restraints of trade, to the ultimate economic disadvantage of all Japanese auto manufacturers.

---

[1]The International Trade Commission released a study earlier this year which contained estimates of the impact of the VER on Japan's sales in the American market: 1981 = 103,000; 1982 = 195,000; 1983 = 574,000; and 1984 = 998,000 units. The ITC report also indicates that the VER increased the average price of a Japanese-made auto by 2.5, 4.8, 10.0 and 14.4 percent respectively each year between 1981 and 1984. See USITC Publication 1648, "A Review of Recent Developments in the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements," February 1985, p. 36.

So, on balance, Japan's auto industry, with the above-mentioned exception of the delayed expansion of the smaller, emerging manufacturers, fared quite well economically under the VER, making more money on each car sold, and avoiding the possibility of an even more severe American political response to their success in this market.

EFFECT OF THE VER ON JAPAN'S GOVERNMENT

The VER allowed Japan's auto manufacturers to maintain, if not increase, their income in spite of growing international resentment of the lop-sided ratio of foreign cars sold in Japan to Japanese sales abroad: no mean feat! But those agencies of government concerned with the auto trade and their individual officials fared even better, considerably expanding their influence over the domestic auto industry--an increasingly important sector of the economy proud of its tradition of independence from government "interference," a sector Japan's economic bureaucrats had found difficult to "manage" in the past.

Moreover, at home they appeared to have achieved this significant expansion of institutional and personal importance in response to "gai-atsu" [foreign pressure], rather than through their own initiative, thereby avoiding the danger of public cri-

ticism for bullying or promotion of self-interest. This bureaucratic bonus may help to explain the equanimity with which MITI officials faced, even encouraged, U.S. pressure for Japanese auto export restraint during the late 1970s and early 1980s.

When "Japan Incorporated" is suggested as a model of that nation's government-business relationship it usually is exaggerated and otherwise dramatized to the point it becomes misleading, especially when presented in a political context. But at least since the 1868 Meiji Restoration, that somewhat artificial historical marker said to demarcate the beginning of Japan's "modern" period, the national government has taken very seriously its responsibility to guide industry along that path to economic development and prosperity which the government has identified as most appropriate. Considered by themselves and even many outside observers to be their society's "best and brightest," Japan's higher civil servants have suffered no sense of inadequacy when dealing with even the most successful and powerful industrialists. They are inclined to believe that they know what is best for the nation, and to consider themselves far more responsible for promoting the national interest as they define it through government intervention in the market than do senior government officials in the United States or in the major European countries.

Business's response to the government's pedagogical attitude has varied, not surprisingly, on the one hand, according to the degree to which the leaders of the various corporate sectors have considered their success dependent upon direct or indirect government support, such as financing, import protection or government procurement, and on the other, on their confidence in making a go of it alone. Japanese business resentment of and resistance to government "interference" seems during the postwar period to have increased somewhat as experience and prolonged prosperity have expanded the private sector's financial reserves and reduced their dependence upon direct and indirect government support. Officials charged with economic responsibilities are inclined to look with disfavor on manifestations of private sector "independence" and "uncooperativeness" when they arise, confident that they themselves are more capable, better informed, and surely in a better position than commercially motivated businessmen to define and promote the national economic interest.

Mixed in with their altruistic attention to the national interest are conscious and unconscious personal concerns. The importance of the latter should not be ignored or under-estimated by American observers, both as clues to understanding and predicting the behavior of Japanese economic bureaucrats, and possibly even as a source of some influence over their behavior in the future.

One significant example of a less altruistic motivation involves the lock-step, up-or-out lifetime employment system of Japan's career higher civil service, within which promotion is determined by seniority, and no one reports directly to an individual with fewer years of service. The system has many advantages, both for the nation and for its elite membership. But one of its less desirable consequences is the forced retirement of career higher civil servants at a relatively early age (early 50s)--while family expenditures and creative energies are still high--in order to maintain the integrity of the program by making room toward the top of the pyramid for rising junior officers.

Each ministry does its best to ease the shock of early retirement for its officials by facilitating their move to a comfortable post in a private or quasi-private corporation soon after they leave government: the oft-mentioned system of "amakudari," or "decent from heaven." And each ministry takes pride in its ability to obtain the most desirable positions for its retirees. This system, in some respects, can be compared--both favorably and unfavorably--with Washington's "revolving door," a personnel practice which creates what are referred to euphemistically as additional "channels of communication" for the cooperating corporation with that part of the government upon which it is most dependent.

The success of the amakudari system requires the interest and cooperation of a large number of corporations. Companies can't really be forced to accept a ministry's retiring senior officials, along with their relatively high salaries and overhead expense, if they feel no need to employ them. They must be enticed to cooperate through anticipation of long-term benefit. Naturally, the closer the relationship between the ministry and the corporate sector--that is, the more the corporation considers its success dependent upon the good will of the government--the more likely it is to agree to provide a comfortable landing field for retiring ministry officials.

If the officially supervised and enforced "voluntary" restraint agreement accomplished nothing else, it certainly heightened the sensitivity of Japan's cash-rich, independent-minded automobile manufacturers to the interests of the government economic bureaucracy. Having won authority to oversee the process through which the share of the total U.S. export quota each company would be allowed to fill was determined, and for enforcement of its implementation, the government suddenly became more important to the executives of Japan's large and small auto manufacturers.

It may help to explain the willingness of Japan's government to extend the quotas--albeit at levels at or near the industry's productive capacity--even in the absence of overt official U.S. pressure, since the extension maintained the government's right to demand information from the auto companies, and in general, to keep an official eye on their activities. This is not to say that the amakudari motive was the sole, or even necessarily the primary, factor in the calculus of Japan's economic bureaucrats as they struggled during the late 1970s and the early 1980s to cope with a vexing source of international trade tension. Nor is it to say that Japan's auto industry suddenly became totally subservient to the government. Rather, it is presented as only one example of a complex set of explanations of the willingness of Japan's economic bureaucracy to handle the auto trade issue in the way they did, and one example of the implications of the VER for Japan's government.

ARE VERs THE WAY TO GO DURING FUTURE TRADE PROBLEMS WITH JAPAN?

It is difficult to provide a definitive, all-weather answer to the question "Should the U.S. government be encouraged to press for VERs similar to that used on autos as a means of dealing with future sectoral trade disputes with Japan?" As with other politically sensitive economic issues, a realistic response requires consideration of prevailing economic and political cir-

cumstances, and, perhaps most important, of all likely alternatives.

It would be naive to advise executive branch officials and legislators to ignore altogether their constituents' pressure for political relief of foreign trade-related problems, even citing the theory of comparative advantage, or evidence that the costs of trade restraints nationwide would outweigh their employment and corporate profit benefits. The very nature of the political marketplace forces competition among its participants for discovery and control of "issues." Situations widely perceived as "problems" become prized targets of opportunity. No issue which has received as much public attention as automobiles is going to be ignored. Political actors gain advantage and justify their existence by proposing and implementing actions to solve problems, not by declaring that the best solution may well be no action at all--even when that might be true. In the absence of a foreign economic policy which includes an effective trade adjustment assistance program, the reality of the political marketplace is sure to force restraints on international trade of some kind when politically significant labor and industrial actors lose enough jobs and market share to imports. The real question is whether or not the VER is the best method of dealing with such problems once they arise.

The VER has been successful, for the most part, in keeping the automobile trade story off the front pages of American newspapers, or at least in shrinking the size of its headlines, for several years, and in reducing its political temperature to a manageable level. It provided some desperately needed economic relief to the American auto industry in the form of increased sales and profits, and rising employment. It may even be credited with prevention of even more economically damaging political action in the absence of such restraint.

But most analysts should agree that the voluntary restraint arrangement in and of itself was a bad thing. Artificially reducing as it did the availability of a product for which there was strong demand, the government's action naturally forced American consumers to pay significantly higher prices for those units they were able to buy. It even helped to raise prices on domestically produced automobiles.[2]

A longer-term negative consequence of the auto VER arrangement was the message its imposition sent to other American industries struggling against competition which was at least partially of foreign origin. That message was that it might be more cost

---

[2]For an estimate of the VER's impact on imported and domestic automobiles which seems relatively free of political bias, see the previously mentioned ITC report, pps. 36 and 39. The authors estimate that by 1984 the VER was adding $1,338 to the cost of the average Japanese import, and $659 to the cost of the average new domestic model.

effective for them to spend their limited resources on the services of Washington lobbyists and public relations operators in an effort to persuade the government to grant them similar import relief, rather than to spend it on R&D or plant and product improvement. Each VER-type arrangement makes it more difficult for the executive branch and the congressional representatives of import-impacted industries to resist home pressure for similar relief.

Yet another negative consequence of the VER method of solving foreign economic problems once they have been politicized is that it places the advantages of initiation, and direct control over the issue, with the Japanese, and leaves the United States in a passive-defensive posture. This approach requires the United States to apply "pressure" on Japan intense enough to persuade them to "voluntarily" reduce exports to our market. It requires members of the executive and legislative branches of government to make threatening noises adequate to convince Japan that they are in for consequences more severe than those of the VER should they continue to allow unfettered exploitation of the U.S. market. That point in the process has come to be known as Japan "getting the message," and the means of achieving that objective is far from an exact science.

Repetition of such threats without ever actually carrying through gradually reduces their credibility. Each round of pressure has to be more spectacular than the last in order for Japan to "get the message." The credibility of our threats is further weakened by the frequency with which Japanese government and industry hire the very government officials responsible for exerting the pressure willing--indeed, eager--to represent Japanese interests directly or indirectly in Washington right after leaving office.[3] This erosion of the credibility and effectiveness of our political pressure tactics has serious negative implications for continued reliance on VER-type solutions for trade friction.

Early in the course of these pressure-building exercises, a responsible executive branch official can be sent to Japan to propose secretly such an arrangement, ensuring delivery of the message, saving time and trouble all around. But for an officially delivered "unofficial" message to be taken seriously in Tokyo, Japanese government and industry leaders still must be convinced the time has come that the consequences of non-compliance--of no "voluntary" restraint--will be worse than those of the proposed VER. So, back to bilateral political theater!

---

[3]The employment by Japanese government and industry interests of former U.S. officials with Japan-related government experience as highly paid "consultants," lobbyists, information collection and public relations operatives has become so commonplace that it appears as if the coverage of Japan's system of amakudari has been extended to Washington!

Given such serious disadvantages, one may well wonder why the VER approach is even considered as a solution to American international trade problems, in place of the direct, more manageable, measures to limit market access now available under American trade law, or even other more creative alternatives. There are two primary reasons. The first is that the VER method allows American negotiators to appear at international trade conferences with clean--at least in the strict legal sense--hands, and to avoid direct blame for protectionist action (and possible imitation). Although it is obvious to everyone involved that the United States intends to reduce international access to part of our market, and it is most likely that other nations go along with the fiction out of fear of retaliation more than anything else, that delicate distinction seems to be important to those in the trade negotiation business.

The second reason is even more attractive: an almost infinite flexibility which provides the political equivalent of "no-fault" insurance protection for its practitioners. In the past, VER promoters have not been expected to define their objectives in any but the vaguest of terms. And this, combined with the lack of a real American foreign economic policy[4]--a

[4]This characterization of American foreign policy may be considered unfair by some observers. And to be sure, certain aspects of American foreign policy concern economic issues. But even there, objectives tend to be defined in diplo-military rather than economic terms, and therefore prove inadequate as guides to foreign economic problem-solving.

specific set of economic objectives and the means with which the government intends to achieve them--means that the results of their performance cannot be judged against any pre-determined criteria or objectives. Pressure on Japan or some other trading partner can be screwed up or down at will, in direct proportion to constituent pressure, and no concrete action on the American side is required, only the threat of action. So, there is little or no danger of being accused of failure.

Considering both the advantages and disadvantages of the VER approach, especially the likelihood that it will become more difficult to use effectively in the future, I am forced to conclude that its implementation is desirable only under extreme conditions, when all conceivable alternatives have even worse implications. When restraint of international access to the American market becomes politically inevitable--an event which itself represents a failure of American foreign economic policy--prompt implementation of the restrictive remedies available under U.S. trade law is preferable to a VER arrangement. And finally, since action in restraint of international trade carries with it such broadly distributed costs, as described above, the government should be required to clearly define the objectives of such action before it is implemented, and to establish criteria by which the policy's results will be judged, ending our system of "no-fault" insurance for American trade policymakers.

Representative LUNGREN. Thank you.

Mr. Hufbauer, now that the voluntary restraint agreement we have with the Japanese on automotive exports has lapsed—you know, they have said they will continue with voluntary export restraints—can we say the American automotive industry is in a better position today to compete on its own in the global economy?

Mr. HUFBAUER. Congressman Lungren, without quibbling on words, I think the VRA has just been replaced by a less visible form of restraint which, in my view, will become more virulent when times change.

Coming to the main thrust of your question, in my prepared statement, I give the record of employment in this industry. Employment dropped from about 929,000 in 1979 to about 623,000 in 1982, and rose to about 720,000 in 1984. Generally we would say that when employment goes up, that's a cause for celebration. When people are out of work, they want their jobs back. However, as a long-term proposition, I doubt that it is in the best interest of this industry to be expanding employment. I think the long-term outlook is for declining employment, for reasons I have suggested. I am afraid that the period of protection that we have given the industry has not been coupled with the more permanent adjustment measures that, to my way of thinking, would have been preferable.

Representative LUNGREN. Now I'm rather intrigued by this option quota that you have come up with. Is it really greatly different than what we've had with high tariffs before, particularlized to industries or products?

Mr. HUFBAUER. It differs in two or three respects.

First, the quantity of goods that would enter the U.S. market would be determined by the amount of quotas that are given out. From the standpoint of most economists, including myself, it's far better to have markets determined by prices rather than by quantity allocations. Once you set the quotas, theoretically the price can go to any level. I would say, right off, that's undesirable, so why am I supporting a quota auction approach?

The reason I'm supporting it is that, in reviewing many cases of special protection in the United States, I see an overwhelming political judgment that quantitative restrictions—in the form of OMA's, VRA's congressionally imposed quotas—are the preferred solutions. There are many reasons for this. There isn't time to go into all the reasons. But the net result is that people prefer quota solutions rather than tariff solutions.

So I think, as a practical matter, that we cannot immediately go to tariffs. Instead, we would go to the quotas auction as an interim step. In the fullness of time, it might be possible to convert quota auctions to tariffs. The auction would have established an appropriate rate. People will have gotten used to the system, and so forth. But, as a starter, I think the quota auction is more feasible than the tariff.

Representative LUNGREN. So if I understand what you're saying, there seems to be political reluctance, domestically, for the acceptance of tariffs, as opposed to these voluntary restraints, but in some ways, it would accomplish the same thing, in terms of revenues going to Government.

Mr. HUFBAUER. Well, under VRA's, VER's, or OMA's no revenue goes to the——

Representative LUNGREN. No, I understand that, but I mean, comparing your approach to tariffs, you're got the funds going to the Government.

Mr. HUFBAUER. That's correct.

Representative LUNGREN. As they would in both circumstances.

Mr. HUFBAUER. That is correct; right.

Representative LUNGREN. Which would probably cause these to be observed by our trading partners as tariffs, under another name.

Mr. HUFBAUER. I'm not saying that I've invented the free lunch. The trading partners, in some circumstances, would not be happy with this approach.

The potential benefit to trading partners—such as Japan in automobiles; or Korea, Brazil, Europe, and other countries in steel; or Europe in book printing—is that our trading partners would see the possibility of degressive protection over a period of time that they cannot now foretell with any certainty under the VRA/OMA/VER type of approach. So the quid, to them, is the time-certainty that Mike Smith spoke of.

I don't think a government can just say "time-certain" and then end protection for troubled industries. The Australian Government has tried that and failed. I think a government has to build a believable political system to get from here to there, and I think a quota auction with revenues earmarked for adjustment would be a more believable system.

Representative LUNGREN. Well, I want to thank both of you for testifying. You've given somewhat unique observations on an overall subject that those of us in the Congress are required to deal with on a fairly regular basis. It sometimes becomes more immediate, depending on what the health of the U.S. economy is at any particular time, but it's something that, as I say, we deal with on a regular basis, and we're always going to be looking at any number of things, whether we call ourselves free traders, protectionists, or pragmatists.

So thank you very much for your testimony. I appreciate it.

Mr. HUFBAUER. Thank you.

[Whereupon, at 4:05 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

STATEMENT OF THE
INTERNATIONAL UNION, UAW
TO THE
SUBCOMMITTEE ON TRADE, PRODUCTIVITY
AND ECONOMIC GROWTH
JOINT ECONOMIC COMMITTEE

July 3, 1985

The UAW welcomes the opportunity to offer its views on the recently ended Voluntary Restraint Agreement (VRA) which limited Japanese exports of passenger cars to the U.S. Our advocacy of an extension of the VRA is well known. We believe the progress made during the past four years and the impending harm to American auto and related workers, communities and the industrial base of this country resulting from the President's decision justified our position.

During the 1981-85 period, several positive developments in the U.S. auto market occurred. They would not have taken place in the absence of the restraint agreement. First, significiant modern small car production capacity was retained in the U.S. The American-based manufacturers have continued to supply this market, which last year accounted for sales of over 45 percent of U.S. output, a total of 3.6 million cars.

Investment in car production plants in the U.S. by Japanese companies, under the impetus of the VRA, contributed to domestic production. There are Honda and Nissan plants in operation and plans for a Mazda plant. The joint venture between Toyota and GM is now turning out cars and there are similar plans for a Mitsubishi-Chrysler venture as well. We are far from satisfied that the level of Japanese investment is even close to being commensurate with the profits made in this market, but a start has been made. Without the VRA, there is a question as to whether any of these decisions by U.S. or Japanese producers would have been made; with its removal, it will take strenuous efforts to maintain the commitments already made to produce in the U.S., and additional investments will be hard to win. While we never called for

making the VRA a permanent fixture, keeping it in place longer would have led to more substantial Japanese investment in the U.S. and would have given Congress and the Administration time to develop a policy to deal with increased auto imports which we are now experiencing.

The restraints on Japanese imports provided an element of stability in this industry, which allowed U.S. firms to make important advances in competitiveness. This occurred even though the most meaningful benefit of the VRA was only felt in the past two years, as the economy recovered from the 1980-82 recession. Large capital investments were made and research and development spending has grown in both dollar value and as a proportion of sales.

The impact of this commitment of funds in the auto industry also directly affects many other capital goods industries which are leaders in advanced technology and subject to intense international competition. The auto industry is a major consumer of computer-aided design equipment, industrial robots, machine tools and electronics as well as the products of other important industries, such as steel, rubber, glass and textiles which are struggling to improve their competitiveness. The size of the market provided by the auto industry for such products stimulates innovations in this wide range of industries which help make up the industrial base of our economy. The stability in the auto market established by the VRA made new investments and R&D spending possible in other industries as well.

Efforts to improve competitiveness also affected labor-management relations. The executives of U.S.-based auto companies have shown a greater appreciation for the knowledge and experience of UAW members in recent years and listened to their ideas regarding plant operations and other workplace issues. This improved working relationship has led to productivity growth of 35 percent and measurably improved product quality. The contract negotiations conducted during the VRA have been marked by realistic discussions of the problems facing the industry and the development of serious programs

designed to increase the job security of our members. We made sacrifices in our contracts in 1982, and our Ford and GM agreements of last year were described by most analysts as "non-inflationary."

The VRA has helped to meet these objectives without sharply increasing car prices. In subcompact cars, the market segment most affected by the VRA, price increases of U.S. cars were quite low. The Bureau of Labor Statistics measure of new car prices rose less than the overall Consumer Price Index for the VRA period.

While the industry has made progress during the period of the VRA, serious problems remain. One of the foremost of these is the current dollar-yen exchange rate. Since 1981, the 25% appreciation in the value of the dollar has given Japanese cars a tremendous cost advantage and overcome the many cost reduction and efficiency promoting programs of U.S. auto makers. The 1984 U.S. deficit with Japan in autos was a staggering $20 billion. We expect this to grow by $5-$7 billion for all of this year in the absence of restraints. The Japanese worldwide trade surplus of $33.6 billion in 1984, and its continuing growth, indicate that the exchange rate is not just a problem for U.S. auto and related producers, but hurts many other industries as well. The VRA was never intended to address this type of ongoing inequity, yet to have removed the VRA while the exchange rate inequity remains, has exposed the industry to a disadvantage it cannot counter on its own.

The U.S. trade deficit, at $123 billion in 1984, is already much too high. Elimination of the VRA will add billions of dollars to this deficit when what is needed are policies to drastically reduce it. Our deficit with Japan was a massive $37 billion in 1984. It may reach $50 billion in 1985, despite repeated efforts to open up export opportunities there. The endless hours of negotiations with Japan from 1980 to 1984 resulted in an increase in our exports from $21 billion to only $24 billion. All of this gain and more will be wiped out by the 1985 increase in Japanese car exports.

The lifting of the VRA produces another inequity. The U.S.-based auto makers have jumped at the chance to abandon domestic production of small cars in their own plants. GM has plans to import 175,000 Isuzu and Suzuki cars from Japan and approximately 80,000 from Daewoo in Korea. Combined with the 240,000 subcompacts produced by its joint venture with Toyota in Fremont, California, this adds up to more small cars than GM has ever sold. Even with the Saturn project, GM will have become one of America's largest importers. Ford and Chrysler have followed this strategy to compete. Ford plans to import 130,000 cars from Mexico and a substantial number from Korea, while Chrysler will raise its Japanese imports to 147,000 this year and to 200,000 in the future. We may be left with domestic production of about one million small cars, all made by Japanese companies or joint ventures, but little or no production by the U.S.-based companies. The failure to continue the VRA is in large part responsible for industry pursuing this plan.

It is clear that the Japanese producers will continue to increase their exports to the U.S. The companies which have not made U.S. investments will attempt to increase their market share through exports, and the flat sales in the Japanese market will push all firms to increase exports to the U.S. to more fully use their available capacity. Since the restraints covering 90% of Japan's non-U.S. auto exports have not been removed or loosened, it is obvious that the U.S. is the only possible destination for higher Japanese output. The announcement by MITI following the expiration of the VRA that Japanese car exports to the U.S. would surge to 2.3 million, a jump of 25% in 1985, showed that those who said the Japanese would exercise restraint were naive. The figures for April 1985 show that this increase in auto exports has already begun. Exports to the U.S. rose 22% and car production plans of the Japanese auto industry for the April-June quarter are at an all time high of 1.9 million units. Sales data for May show that the Japanese share increased to 19.2% from 14.7% in April. Sales of Japanese imports leaped 41%, while sales of domestic cars grew by only 2.4%

The adverse impact of this strategy will fall on American workers and communities dependent on domestic production of small cars. Workers in the industry have already seen employment fall by over 20% in the past 5 years, despite the VRA. They have watched friends and relatives suffer long-term unemployment which, for many, means the loss of savings, homes, health and, for some, even their dignity. A recent study of unemployed Michigan auto workers revealed that household income fell by an average of 42%, savings were exhausted by nearly half of those who had any and more than half of the unemployed had no employer-paid health insurance during the period of layoff. The lost income of auto workers leads to further income loss in auto-dependent communities and causes broader unemployment problems. Those workers remaining have made sacrifices and helped increase efficiency in the plants to keep their jobs. Yet they will be the ones left behind if the auto makers can freely import small cars.

The Department of Commerce recently projected that by 1988 Japan will increase its exports more than 50% from the 1984 level to 3.1 million cars. This would lead to a further loss of more than 250,000 auto and related jobs. The companies can make as much profit from foreign production; executives can receive the same bonuses. We believe these companies have an obligation not only to their workers but to communities which have come to depend on them for decent jobs and stable development. The high standard of living and high skills of American workers have provided the products and the market which enabled these companies to produce their profits. It is the responsibility of these companies to fulfill their obligation to those who have produced the profits they now enjoy. We believe this can be done only if the share of the U.S. market supplied by imported vehicles is controlled. The UAW will continue to pursue that objective.

FACT SHEET July 3, 1985

Treatment of Japan by Other Major Auto-Producing Countries

	Local Content By Law	Local Content In Practice	Local Production of Japanese Cars and Trucks	Tariff	Treatment of Japan
Australia	Yes		Yes	35-57%	
Belgium				10.8%[3]	Japan's voluntary export restraint (VER) holds its share to 20% of Belgium market.
Brazil	Yes		Yes	185-205%	
Canada				10.4%	VER around 20%
France		Yes[2]		10.8%[3]	Customs prevents entry of more than 3% of French market.
Germany				10.8%	VER at 10% of market
Italy		Yes[2]	Yes	10.8%[3]	Official quota of 2,200 Japanese cars
Mexico	Yes		Yes		
Spain	Yes		Yes	68%	
U.K.		Yes[1]	Yes	10.8%[3]	VER at 10-11%
U.S.A.			Yes	2.7%	Open Market

1 While holding Japanese companies to less than 11 percent of their market, the U.K. has negotiated for government-owned BL, Ltd. to build Honda Acclaims under license. According to Nissan, pressure from U.K. Prime Minister Thatcher led to its decision in early 1984 to assemble 24,000 cars a year there - all to be counted against Nissan's U.K. import quota.

2 France and Italy stopped treating British-assembled Hondas as Japanese imports subject to their stiff quotas only after they achieved the 60 percent European content sufficient for treatment as an EC product.

3 Value-added taxes applied to tariffs raise their effective rate to 13-14 percent.

Facts

FACT SHEET

May 13, 1985

BIG THREE CAPTIVE IMPORT VEHICLE SOURCING

So far, vehicle outsourcing has been modest -- about 176,000 (1.6%) of the 11.2 million new cars and trucks sold by the Big Three in the U.S. in 1984 were produced overseas. But by 1990, if the companies' plans cannot be reversed, that figure will increase to about 1.8 million vehicle-equivalents.

	Type of Vehicles*	Approximate Annual Number Of Units		Beginning Date
1984 CAPTIVES				
GM (Isuzu, Suzuki)	Small vehicles	13,000		
Chrysler (Mitsubishi)	Small cars & trucks	143,000		
Chrysler de Mexico	K cars	30,000		
GM de Mexico	Car pickup	20,000		
PLANNED: CONFIRMED				
GM - Daewoo	Small car	80,000		1988
GM - Isuzu	Medium truck	1,000		1985
GM - Isuzu (Chevy Spectrum)	Small car	200,000		1984
GM - Suzuki (Chevy Sprint)	Small car	90,000		1984
GM - GM de Mexico (El Camino)	Car pickup	30,000		1984
GM - DINA (Mexico)	Diesel Truck	70,000		1986
Ford - Mazda (Mexico)	Small car	130,000		1988
Ford - Ford of Europe (Merkur)	Luxury car	25-100,000	a/	1985
Ford - Ford do Brazil	Medium Truck	1,400-2,000		1985
Ford - KIA (Korea)	Mini car	60-100,000		1988
Chrysler - Chrysler Mexico	K cars	30,000		1984
Chrysler - Mitsubishi	Small cars	200,000		1988
RUMORED IN-THE-WORKS				
Chrysler de Mexico	Small truck	20,000		1985
Ford	Small car	300-400,000	b/	1990
Ford - Ford Lio Ho (Taiwan)	Small car	50,000		1987
Chrysler - Mitsubishi	Mini car	60-100,000		1988
Chrysler - Mazerati	2-seater	20,000		1988

* Note: The list above does not include cars produced in joint ventures (e.g., NUMMI) or the low-U.S. content cars to be sold to Big Three dealers by the U.S. assembly plants of foreign-based OEMs (e.g., Flat Rock).

a/ 25,000 Merkur in 1985; total to approximately 100,000 after addition in 1987 of Granada model.

b/ The Escort/Lynx successor, code named Apex, has no "home" yet.

SOURCES: Wall Street Journal, Detroit Free Press, and Ward's Automotive Reports.

FACT SHEET June 21, 1985

1985 ALLOCATION OF JAPANESE IMPORTS

Despite the fact that even the U.S. Department of Commerce is predicting a 30% market share for Japanese imports by 1988, the Reagan Administration decided not to request continued restraint beyond March 31, 1985. Japanese companies have been asked by their government not to import more than 2.3 million vehicles in fiscal year 1985 (April 1, 1985 — March 31, 1986). Each firm has been allocated a share of the total volume by the Japanese Ministry of International Trade and Industry. The following table shows the 1984 and 1985 allocations for each firm. **The total allocation for Chrysler and GM captives was increased 150,000 — from 135,000 to 285,000 vehicles.**

Firm	Percent Increase	Fiscal Year Allocation* 1984	1985
Toyota	12.5%	551,800	620,760
Nissan	12.5	487,100	547,920
Honda	15.1	372,400	428,590
Mazda	32.4	173,500	229,720
Mitsubishi	52.0	122,400	186,010
MMSA	30.8	34,800	45,520
Chrysler	**60.4**	**87,600**	**140,490**
Isuzu	134.0	50,000	117,100
AIM	30.0	20,000	26,000
GM	**200.0**	**30,000**	**91,100**
Suzuki	**209.0**	**17,000**	**52,500**
Subaru	54.6%	75,800	117,200
		1,850,000	2,300,000

* Does not include station wagon type vehicles which have separate allotment of over 100,000 for 1985.

Box indicates GM and Chrysler captive vehicles.

FACT SHEET June 26, 1985

THE AUTO INDUSTRY

- The annual rate of domestic new car sales for May was 8.4 million units, up slightly from 8.3 million in May 1984 but down from 8.7 million in April — largely because special financing programs were ended and because imports were up.

- Imports were selling at an annual rate of 2.8 million, up substantially from a rate of 2.4 million in April and 2.5 million in May 1984. It would appear that in May we began to see the impact of ending VRA.

- Japanese vehicles sold at an annual rate of 2.2 million in May, up 24% from the annual rate of 1.8 in April. The Japanese year-to-date import share is 17.3%, up somewhat from the year-to-date share in April. The Japanese Ministry of International Trade and Industry (MITI) has requested the Japanese auto companies to restrain fiscal 1985 imports to a level of 2.3 million units, up 24% from the 1984 level of 1.85 million units. (See next fact sheet for allocation by company.)

- Sales so far this year of domestic new cars are 3.6 million — a strong annual rate of 8.5 million — up 3% from last year but still down 5% from the first five months of 1978. Car sales have been especially strong in the compact segment due to financing incentives. Domestic truck (including van) sales were 1.65 million, up 13% from 1984 and up 1% from 1978.

- While domestic sales are approaching the level of 1978, employment is still well below the 1978 period.

January-May Retail Auto Sales in the U.S.

	1985	1984	1978	Change 85/84	Change 85/78
Domestic cars	3,638,152	3,518,973	3,820,559	+ 3%	- 5%
Japanese Cars	814,803 (17.3%)	764,365 (16.9%)	579,838 (12.3%)	+ 7	+ 41
European Cars	254,121	243,059	282,526	+ 5	- 10
Imported Cars	1,068,724 (22.7%)	1,007,424 (22.3%)	862,364 (18.4%)	+ 6	+ 24
Total Cars	4,706,876	4,526,397	4,682,923	+ 4	0
Domestic Trucks	1,653,805	1,460,748	1,633,181	+13	+ 1
Japanese Trucks	316,706 (16.1%)	241,831 (14.2%)	130,280 (7.3%)	+31	+143
Total Trucks	1,970,511	1,702,579	1,763,461	+16	+ 11
Total Domestic	5,291,957	4,979,721	5,453,740	+ 6	- 3
Total Imported	1,385,430 (17.7%)	1,249,255 (17.3%)	942,644 (14.5%)	+11	+ 47
Total Japan	1,131,309 (14.5%)	1,006,196 (13.9%)	710,118 (10.9%)	+12	+ 59
Grand Total Sales	7,808,696	7,235,172	6,507,468	+ 3%	+ 20%